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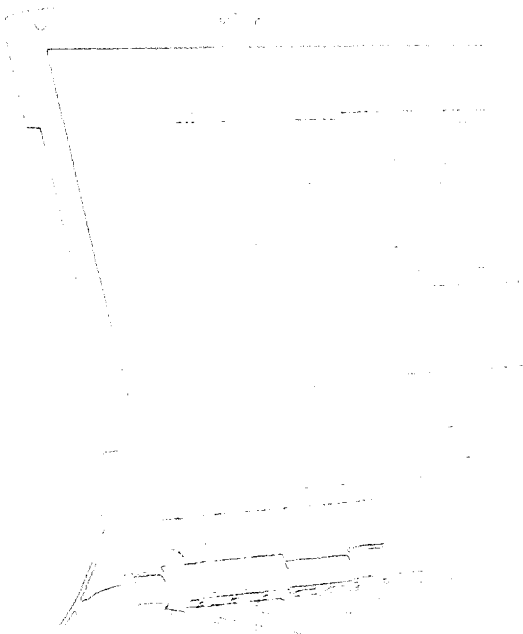
2004 ANNUAL REPORT



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Clear direction for healthcare information solutions



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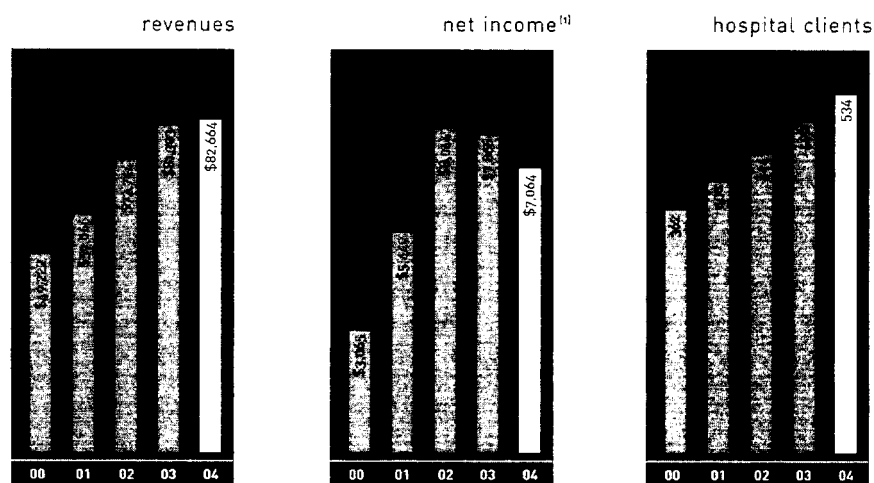
CPSI is a leading provider of healthcare information solutions for community hospitals with over 500 client hospitals in 45 states. Founded in 1979, the Company is a single-source vendor providing comprehensive software and hardware products, complemented by complete installation services and extensive support. Its fully integrated, enterprise-wide system automates clinical and financial data management in each of the primary functional areas of a hospital. CPSI's staff of over 750 technical, healthcare and medical professionals provides system implementation and continuing support services as part of a comprehensive program designed to respond to clients' information needs in a constantly changing healthcare environment. For more information, visit www.cpsinet.com.

Annual Meeting

The annual meeting of stockholders will be held on May 12, 2005, at 9:00 a.m. Central time at the Mobile Convention Center, One South Water Street, Mobile, Alabama.

financial highlights

	Year Ended December 31,	
	2004	2003
Total sales revenues	\$ 82,664	\$ 81,303
Total cost of sales	49,576	48,405
Gross profit	33,088	32,898
Total operating expenses	21,886	20,352
Operating income	11,202	12,546
Interest income, net	258	216
Other income	243	122
Net income before taxes	11,703	12,884
Provision for income taxes	4,639	5,018
Net income	\$ 7,064	\$ 7,866
Basic earnings per share	\$ 0.67	\$ 0.75
Diluted earnings per share	\$ 0.67	\$ 0.75
Weighted average shares outstanding:		
Basic	10,490	10,488
Diluted	10,536	10,537



⁽¹⁾ Net income for years 2000 and 2001 are pro forma for comparative purposes.

to our stockholders:

During our quarter-century of operation, CPSI has established itself as a leader in providing information technology solutions to small to medium sized hospitals and their associated entities, such as nursing homes, home health agencies and physician clinics.

2004 began with the promise of an improving financial climate for community hospitals based on the increased Medicare reimbursement contained in the Medicare Modernization Act passed by Congress in late 2003. In concert with these improved financial dynamics, the demand for integrated healthcare information technology solutions, most notably advanced clinical applications that provide caregivers with a real-time electronic medical record, steadily grew throughout the year. CPSI's results mirrored this trend, beginning with a difficult yet profitable first quarter and concluding with a fourth quarter that produced record revenues, earnings and free cash flow. As a result, we ended 2004 with great optimism for what lies ahead for our company and our customers, employees and stockholders.

During our quarter-century of operation, CPSI has established itself as a leader in providing information technology solutions to small to medium sized hospitals and their associated entities, such as nursing homes, home health agencies and physician clinics. We have achieved this position by continually striving to meet the unique needs of our community healthcare clients. Only CPSI offers an integrated, 100% internally developed software solution for every functional area of the hospital and then combines these applications with complete hardware sales and support, total system service, regular software upgrades and comprehensive on-site training. We can also manage the hospital's entire business office operations, including patient billing and insurance claims processing. We are truly a single-source solution.

CPSI is poised to take advantage of improving market conditions.

It is well documented that information technology spending in the healthcare sector as a percentage of revenue has consistently lagged behind IT spending in other industries. For a variety of reasons, that situation is changing. Community hospitals now recognize that information technology systems are not only desirable, but also a competitive necessity that can no longer be ignored.

Hospitals today are operating with increased awareness of the severe impact of medical errors. Each year, nearly 100,000 deaths nationwide are attributed to medical error, costing the healthcare industry approximately \$4.5 billion annually. Integrated data management, which helps assure that all relevant hospital personnel have real-time access to critical patient clinical information, directly correlates with a reduced incidence of error.

Federal legislation essentially demands that hospitals upgrade their IT systems in all areas of their operations. HIPAA, the Health Insurance Portability and Accountability Act, mandates that hospitals ensure the security and privacy of their data, a virtually impossible task without electronic record-keeping, and that they adopt uniform electronic transaction code sets. As they near the deadlines for HIPAA compliance, hospitals are moving aggressively to improve their data management and are finding that CPSI can help them meet these new national standards, as well as any future standards for data exchange.

The Bush administration has a recently established goal of nationwide adoption of healthcare information technology in order that all Americans have a personal electronic medical record within 10 years. This initiative enjoys bipartisan political support and growing acceptance among the healthcare

community. Several bills have been introduced in Congress that are designed to provide funding for information technology investments by community hospitals and to offer financial incentives through improved Medicare reimbursement based on a hospital's utilization of an electronic patient record and computerized physician order entry applications.

Hospitals are recognizing that information technology is becoming particularly important to their recruitment and retention efforts. IT investments not only produce dividends in the form of improved productivity, but they are also becoming a necessity for attracting key clinical personnel. Many physicians are now demanding electronic access to the records of their patients. Because the success of community hospitals depends so heavily on recruiting and retaining physicians, investing in sophisticated IT systems inevitably has become a key part of the overall strategy. Similarly, with a growing and persistent shortage of experienced nurses in this country and with a direct correlation between reduced paperwork and increased job satisfaction, information technology investment also supports hospitals' efforts to maintain a quality nursing staff.

As a result of these factors, we believe that healthcare IT spending will continue to accelerate going forward. According to a recent study conducted by the Healthcare Financial Management Association, hospital CFOs expect to see a 14% annual increase in capital spending over the next five years, with information technology representing the largest portion of that investment. We believe that CPSI is well positioned to reap the benefit of this demand and to capture a growing share of a largely fragmented market.

CPSI is responding to the dynamics of the marketplace.

Our integrated clinical applications are well suited to meet the demands of community hospitals for a complete electronic medical record across the continuum of care, inclusive of the hospital and any associated nursing homes, physician clinics and home health agencies. To illustrate this growing demand, consider that today only one in four hospitals among our target market has a point-of-care nursing documentation system, less than one in five has a system for electronic picture archiving and fewer than one in ten has implemented computerized physician order entry and bedside medication verification applications. In other words, more than 90% of our market lacks the electronic medical records that are becoming a necessity.

Three of our specialized clinical applications are proving to be especially valuable to hospitals as they move toward a completely electronic chart. Our ImageLink picture archiving and communication system (PACS) allows all radiology films, such as MRIs, CT scans and ultrasound, to be captured and stored as digital images. As a result, all of the various physician specialists who may be involved in a patient's care can view these diagnostic-quality pictures from any point within the hospital or remotely from their offices or home computers. ChartLink is our web-based patient chart that includes computerized physician order entry functionality. By allowing physicians to access patient information securely through the hospital's website and to enter medication and ancillary orders electronically, the system improves efficiency while eliminating the handwritten

With solid fundamentals as a foundation, CPSI is well positioned to capture an increasingly larger share of a market that will continue to grow as information technology penetrates the healthcare industry.

orders that can lead to medication errors. Our Nursing Point-of-Care application, which relies on wireless and touch-screen technology, enables caregivers to access and enter patient data in real time directly at the bedside.

We believe that these clinical modules, entirely designed and built by CPSI, will contribute significantly to our success over the next few years and will play a major role in our growth strategy.

At the same time, our outsourcing services, which include patient statement printing, electronic claims processing and complete business office outsourcing, enjoyed strong growth in the second half of 2004, with revenues during that period representing 12% of total sales. For the fourth quarter, outsourcing revenue increased 67% over the same period in 2003. We believe that as our customer base continues to place a stronger emphasis on their core mission of delivering quality patient care, they will look to CPSI as a cost effective and efficient solution for their business processing needs.

Our fundamentals are strong. We believe our future is even stronger.

CPSI will continue to pursue the same steady, long-term growth that we have experienced over the past 25 years. In doing so, we will continue to employ the most conservative revenue recognition policies in the industry. For example, over the last two years, our cash collections exceed our gross revenues, and our free cash flow is greater than our net income. CPSI has no debt and had \$1.31 per share in cash at the end of 2004, while continuing to pay a quarterly dividend to our stockholders. Finally, 57% of our annual revenue in 2004 was recurring revenue.

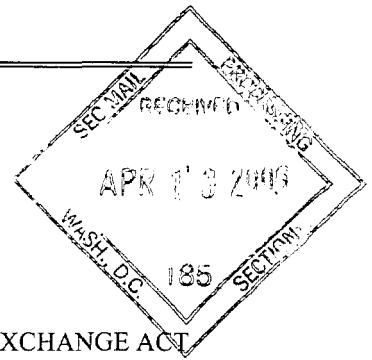
With solid fundamentals as a foundation, CPSI is well positioned to capture an increasingly larger share of a market that will continue to grow as information technology penetrates the healthcare industry. We believe that healthcare information technology offers a greater opportunity than ever before, and we are prepared to make the most of it. We are grateful for your support and your investment in our future. We are also grateful to our customers, who, with their mission of caring, understand the value of what we do in helping them to fulfill that mission.

Sincerely,



David A. Dye
President and Chief Executive Officer

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549



FORM 10-K

- ☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004 OR
- ☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____.

Commission file number: 000-49796

COMPUTER PROGRAMS AND SYSTEMS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction
of Incorporation or Organization)

74-3032373
(I.R.S. Employer
Identification No.)

6600 Wall Street, Mobile, Alabama
(Address of Principal Executive Offices)

36695
(Zip Code)

(251) 639-8100

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$.001 par value

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒
No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).
Yes ☒ No ☐

The aggregate market value of common stock held by non-affiliates of the registrant at June 30, 2004 was \$131,847,799.

As of March 11, 2005 the registrant had outstanding 10,489,849 shares of its common stock.

DOCUMENTS INCORPORATED BY REFERENCE IN THIS FORM 10-K:

Portions of the definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 12, 2005 are incorporated by reference into Part II and Part III of this report.

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* Portions of the definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 12, 2005 are incorporated by reference in Part II and Part III of this Form 10-K.

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements can be identified generally by the use of forward-looking terminology and words such as "expects," "anticipates," "estimates," "believes," "predicts," "intends," "plans," "potential," "may," "continue," "should," "will" and words of comparable meaning. Without limiting the generality of the preceding statement, all statements in this Annual Report relating to estimated and projected earnings, margins, costs, expenditures, cash flows, growth rates and future financial results are forward-looking statements. We caution investors that any such forward-looking statements are only predictions and are not guarantees of future performance. Certain risks, uncertainties and other factors may cause actual results to differ materially from those projected in the forward-looking statements. Such factors may include:

- overall business and economic conditions affecting the healthcare industry;
- saturation of our target market and hospital consolidations;
- changes in customer purchasing priorities and demand for information technology systems;
- competition with companies that have greater financial, technical and marketing resources than we have;
- failure to develop new technology and products in response to market demands;
- fluctuations in quarterly financial performance due to, among other factors, timing of customer installations;
- failure of our products to function properly resulting in claims for medical losses;
- government regulation of our products and customers, including changes in healthcare policy affecting Medicare reimbursement rates; and
- interruptions in our power supply and/or telecommunications capabilities.

For more information about the risks described above and other risks affecting us, see "Risk Factors" beginning on page 31 of this Annual Report. We also caution investors that the forward-looking information described herein represents our outlook only as of this date, and we undertake no obligation to update or revise any forward-looking statements to reflect events or developments after the date of this Annual Report.

PART I

ITEM 1. BUSINESS

Overview

We are a healthcare information technology company that designs, develops, markets, installs and supports computerized information technology systems to meet the unique demands of small and midsize hospitals. Our target market includes acute care community hospitals with 300 or fewer beds and small specialty hospitals. We are a single-source vendor providing comprehensive software and hardware products, complemented by data conversion, complete installation and extensive support. Our fully integrated, enterprise-wide system automates the management of clinical and financial data across the primary functional areas of a hospital. In addition, we provide services that enable our customers to outsource certain data-related business processes which we can perform more efficiently. We believe our products and services enhance hospital performance in the critical areas of clinical care, revenue cycle management, cost control and regulatory compliance. From our initial hospital installation in 1981, we have grown to serve 530 hospital customers across 45 states and the District of Columbia. In 2004, we generated revenues of \$82.7 million from the sale of our products and services.

Industry Dynamics

The healthcare industry is the largest industry in the United States economy. The Centers for Medicare and Medicaid Services, or "CMS," has calculated that fiscal 2004 total healthcare expenditures in the United States were approximately \$1.9 trillion, or approximately 15.7% of the U.S. gross domestic product. CMS estimates that by fiscal 2013 total U.S. healthcare spending will reach \$3.4 trillion, or 18.4% of the estimated U.S. gross domestic product.

Hospital services represents one of the largest categories of total healthcare expenditures. According to CMS, in fiscal 2005 spending on hospital services will amount to approximately \$585.8 billion, or 30.5% of total healthcare expenditures. According to the American Hospital Association, there are approximately 4,900 community hospitals in the United States, with approximately 4,100 in our target market of hospitals with 300 or fewer acute care beds. In addition, there is a market of small specialty hospitals that focus on discrete medical areas such as surgery, rehabilitation and psychiatry.

Notwithstanding the size and importance of the healthcare industry within the United States economy, the industry is constantly challenged by changing economic dynamics, increased regulation and pressure to improve the quality of healthcare. These challenges are particularly significant for the hospitals in our target market due to their more limited financial and human resources. However, we believe healthcare providers can successfully address these issues with the help of advanced medical information systems. Specific examples of the challenges facing healthcare providers include the following.

Changing Economic Dynamics. The federal Balanced Budget Act of 1997, or "BBA," significantly lowered Medicare reimbursements for hospital services. These reductions were projected to total over \$250 billion over five years. While the Budget Refinement Act of 1999 and the Benefits Improvement Act of 2000 lessened the impact of the BBA, aggregate federal reimbursement for hospital services is still significantly below pre-1997 levels. Additionally, the Medicaid program, which is a federal/state program managed by the individual states and dependent in part on funding from the states, is in crisis due to the increasing cost of healthcare and the detrimental effect of the lagging economy on state revenues. As a result of the recent enactment of the Medicare Prescription Drug, Improvement and Modernization Act of 2003, however, community hospitals began to experience improved Medicare

reimbursement in 2004. Continuing in 2005 and over the next nine years, this legislation is expected to raise Medicare reimbursements to rural hospitals by an estimated \$25 billion.

Health Insurance Portability and Accountability Act. The federal Health Insurance Portability and Accountability Act of 1996, or "HIPAA," requires the implementation of national guidelines for information management by healthcare organizations. Among other things, HIPAA mandates uniform electronic transactions and code sets, improved data security and increased patient privacy. Final regulations for privacy standards became effective in April 2003. Final regulations for electronic transaction/code set standards were adopted in February 2002 and became effective in October 2003. CMS, however, is currently allowing providers and payors to continue utilizing non-compliant transaction code sets. The length of this grace period has not yet been determined. The final rules for security standards were published in February 2003, and covered entities have until April 2005 to comply with the new security standards. The CPSI system is compliant with all applicable HIPAA rules and regulations currently in force. However, as the regulations continue to evolve due to the dynamic nature of governmental action and guidance, future changes to the system may be necessary.

HIPAA continues to be a major influence as illustrated by the results of the 16th Annual HIMSS Leadership Survey sponsored by Superior Consultant Company. Survey respondents consider HIPAA compliance more than any other matter as a top business issue that will affect healthcare in 2005 and 2006. Approximately 44% of respondents identified upgrading information technology systems to meet HIPAA requirements as the number one information technology priority for their organizations. Approximately 53% of respondents identified increased patient safety as their number one priority. In addition, results of the Winter 2004 Healthcare Industry HIPAA Compliance Survey conducted by HIMSS and Phoenix Health Systems indicate that HIPAA readiness is still a serious concern. While respondent hospitals are decreasing their HIPAA compliance budgets for 2005, the respondent hospitals are still budgeting significant dollars to address HIPAA concerns. Vendors that offer information solutions utilizing a common architecture and database structure, such as CPSI, are well positioned to provide healthcare participants with effective solutions to the HIPAA requirements.

Activism for Improved Clinical Care. In November 1999, the Institute of Medicine published a report entitled "To Err is Human: Building a Safer Healthcare System." The report indicated that avoidable medical error is one of the top ten leading causes of death in the United States. The report also estimates that medical error may add as much as \$14.5 billion of preventable cost to the healthcare industry. As a result of this study, automated medical information systems have been increasingly identified as a key to improving patient care and reducing medical errors. For example, the Leapfrog Group, a consortium of more than 100 public and private organizations including General Motors, General Electric, AT&T and IBM, recommends that its members utilize hospitals with certain automated medical information systems that are designed to limit medical errors. Moreover, California has adopted legislation requiring hospitals to use automated medical information systems. We believe hospitals utilizing fully integrated enterprise-wide medical information systems that allow professionals real-time access to information such as electronic charts, treatment protocols and pathways, pharmaceutical records and treatment schedules will be favored by large employers and government payers.

While economic, regulatory and consumer pressures such as those described above have increased rapidly over the last several years, we believe healthcare organizations have historically underinvested in information technology and services compared to other industries. This underinvestment has caused healthcare providers to rely on non-integrated, complex and inefficient information systems. A hospital's failure to adequately invest in modern medical information systems could result in fewer patient referrals, cost inefficiencies, lower than expected reimbursement, increased malpractice risk and possible regulatory infractions.

In the face of decreasing revenue and increasing pressure to improve patient care, healthcare providers are in need of management tools that (1) increase efficiency in the delivery of healthcare

services, (2) reduce medical errors, (3) effectively track the cost of delivering services so those costs can be properly managed and (4) increase the speed and rate of reimbursement. We believe the industry has begun to embrace information technology as a management tool, evidenced by the fact that approximately 42% of the respondents to the 16th Annual HIMSS Leadership Survey referenced above predicted a definite increase in their organizations' information technology operating budgets during 2005, with an additional 34% of the respondents predicting a probable increase in their organizations' information technology operating budgets during 2005. We believe these dynamics will allow for future revenue growth.

Our Solution

We have tailored an information technology solution that effectively addresses the specific needs of small and midsize hospitals. Due to their smaller operating budgets, community hospitals have limited financial and human resources to operate manual or inefficient information systems. However, these hospitals are expected to achieve the same quality of care and regulatory compliance as larger hospitals, placing them in a particularly difficult operating environment.

We believe that the CPSI solution meets this challenge. We provide fully integrated, enterprise-wide, HIPPA compliant medical information systems and services that collect, process, retain and report data in the primary functional areas of a hospital, from patient care to clinical processing to administration and accounting. As a key element of our complete solution, we provide ongoing customer service through regular interaction with customers, customer user groups and extensive customer support. Further, we offer outsourcing services that allow customers to avoid some of the fixed costs of a business office. We are capable of providing a single-source solution for small and midsize hospitals, making us a partner in their initiatives to improve operations and medical care.

Our customers continuously communicate with us through our support teams and through organized user groups, allowing us to continue to provide a state-of-the-art solution that meets their specific needs. By remaining sensitive and responsive to the ever-changing demands of our customers and regularly updating our products, we believe we provide an information technology solution that meets the needs of community hospitals. Our business has continued to grow because we have successfully addressed the needs of community hospitals for fully integrated enterprise-wide information systems that allow them to improve operating effectiveness, reduce costs and improve the quality of patient care.

Strategy

Our objective is to continue to grow as a leading provider of healthcare information technology systems and services to small and midsize hospitals by following the same strategy that we have successfully pursued for over twenty-five years, the key elements of which are described below.

Deliver a Single-Source Solution. When a customer purchases the CPSI system, we provide everything necessary for the customer to implement and use our system. We deliver the application software, computer hardware, peripherals, forms and supplies used in the comprehensive information network. Our installation teams work extensively with each customer to convert existing data to the new system, to install all of the necessary equipment and to train hospital personnel to use our system. After installation, our support teams answer and address customer questions and issues related to any aspect of the system. We also offer customers additional services such as business office outsourcing, electronic billing outsourcing and ISP services. We believe our single-source approach to delivering a complete information system makes our system easier and more convenient for customers to understand and manage, which results in greater customer satisfaction and retention.

Provide Enterprise-Wide, Fully Integrated Software Applications. We have developed all of our software products internally as part of our fully integrated system architecture. Our experience has taught

us that using a fully integrated system in the primary functional areas of a hospital ensures compatibility among applications and avoids pitfalls associated with interfacing disparate systems. Our system utilizes one central database where information is stored and used by all of our software applications. With our single database model, our systems provide secure, real-time access to all information across multiple applications for all those needing such access, including physicians, nurses, laboratory technicians, pharmacists, clinicians and other users. The enterprise-wide, fully integrated nature of our system also allows customers to monitor user access to information for purposes of compliance with new federal and state privacy regulations.

Maintain Commitment to Customer Oriented Operating Philosophy. A key factor in our success has been our focus on customer service and support. We make available to our customers experienced support teams that can assist with any question or problem. We currently have a greater than one to one support staff to customer ratio. Our support teams are extensively trained, and our employees are generally promoted from within so that they have a thorough knowledge of our system and a commitment to our culture. Because all of our customers use the same version of our system, our support teams can be more effective by maintaining a complete understanding of a single system. As part of our commitment to system support, we actively solicit customer feedback regarding ways in which we can improve the effectiveness and efficiency of our systems. To further this goal, we have organized our customers into a national user group to promote the exchange of information regarding our system and to identify product enhancements based on our customers' operational experiences. We believe our user group concept is a key component of our success by positively impacting customer satisfaction and retention and by enhancing product development and system functionality. We will continue to focus on our national user group as a key component to our goal of maintaining and growing our customer base and market share.

Expand Presence in Target Market. We will continue to target small to midsize domestic hospitals of 300 or fewer acute care beds. We believe this market of approximately 4,100 community hospitals nationwide has been traditionally overlooked and underserved by other healthcare technology companies. In addition, a number of our customers are small specialty hospitals that focus on discrete medical areas such as surgery, rehabilitation and psychiatry. We intend to continue gaining customers from this market segment. Our system can help these smaller hospitals reduce costs and increase their operating efficiencies. We believe our personalized marketing approach and emphasis on customer relationships are attractive to the management of these hospitals. We also believe our system is well-suited to hospitals of this size because they typically demonstrate a greater commitment than larger hospitals to the concept of an enterprise-wide, fully integrated system. While 92% of our current customers are hospitals of 100 acute care beds or less, we believe there is a substantial opportunity in the future to increase our market share among hospitals with 100 to 300 acute care beds. In addition, we will continue to sell additional services and software products to our existing customers who have not purchased our complete package of services and software applications.

Emphasize Recurring Revenue Opportunities. In addition to revenues from new system installations, we have developed and will continue to develop sources of recurring revenues. Our current principal source of recurring revenues is our support and maintenance fees paid by existing customers. As our customer base grows, our recurring revenues from support and maintenance fees should also grow. We believe growth in recurring revenues will also continue to come from our outsourcing services, which we market to our existing customers as well as new customers. These services include electronic billing, patient statement processing, business office outsourcing, ISP services and web site hosting. We also provide our software products on an ASP basis. When we provide ASP services, we maintain a customer's computer server in our facility and provide our system to the customer through remote access. Instead of the one-time system purchase price, these customers pay a monthly fee for the term of the ASP customer agreement, generating recurring revenues.

Our Products and Services

Recent Developments

We completed development of the following new products during 2004, and initial installations in customer facilities occurred during the fourth quarter of 2004:

Electronic Forms. The Electronic Forms module replaces paper-based patient data and care forms with user-defined electronic ones. Displayed and completed on-line using Microsoft's Internet Explorer, the module's forms are easy to use and can be customized to meet needs such as emergency department triage, trauma, and assessments, modality worksheets, consent for treatment, information release requests and transfers. Completed forms become a permanent part of the patient's electronic medical record with access provided to patient care forms from within the clinical record. In addition to their convenience, electronic forms are also a more efficient use of system resources with each form requiring significantly less storage space than a comparable scanned document.

Application Portal. The Application Portal allows clients to access our applications remotely via Microsoft Internet Explorer and the Internet without requiring the loading of any additional client software on the accessing PC. User information and data accessed is secured with HIPAA compliant 128 bit cipher strength Secure Socket Layer (SSL) encryption. Remote access using the Application Portal results in no discernable difference to the user in software functionality.

Systems

We offer a full array of software applications designed to streamline the flow of information to the primary functional areas of community hospitals in one fully integrated system. We intend to continue to enhance our existing software applications and develop new applications as required by evolving industry standards and the changing needs of our customers. Pursuant to our customer support agreements, we provide all of our customers with software enhancements and upgrades typically twice each year. See "--Support and Maintenance Services." These enhancements enable each customer, regardless of its original installation date, to have the benefit of the most advanced CPSI products available. Our software applications:

- provide automated processes that improve clinical workflow and support clinical decision-making;
- allow healthcare providers to efficiently input and easily access the most current patient medical data in order to improve the quality of care and patient safety;
- integrate clinical, financial and patient information to promote efficient use of time and resources, while eliminating dependence on paper medical records;
- provide tools that permit healthcare organizations to analyze past performance, model new plans for the future and measure and monitor the effectiveness of those plans;
- provide for rapid and cost-effective implementation, whether through the installation of an in-house system or through our ASP services; and
- increase the flow of information by replacing centralized and limited control over information with broad-based, secure access by clinical and administrative personnel to data relevant to their functional areas.

Our software applications are grouped for support purposes according to the following functional categories:

- Patient Management
- Financial Accounting
- Clinical
- Patient Care
- Enterprise Applications

Due to the integrated nature of the CPSI system, our software applications are not marketed as distinct products, and our sales force attempts to sell all applications to each customer as a single product. New customers must purchase from us and install the core applications of patient management and financial accounting and all hardware necessary to run these applications. In addition to the core applications, customers may also acquire one or more of our clinical, patient care and enterprise applications. Approximately one-third of our customers have purchased a combination of applications that meet their enterprise-wide information technology needs.

The general functional categories, as well as the software applications in each of these categories, are described below.

Patient Management. Our patient management software enables a hospital to identify a patient at any point in the healthcare delivery system and to collect and maintain patient information throughout the entire process of patient care on an enterprise-wide basis. The single database structure of our software permits authorized hospital personnel to simultaneously access appropriate portions of a patient's record from any point on the system. The patient management software performs the following functions:

Registration

- records patient admissions, discharges and transfers
- manages patient status, room assignments and recurring charges
- keeps information available to all hospital personnel in formats designed for their particular requirements

Patient Accounting

- records patient charges and maintains accounts receivable information including aging, service charges and cash receipts
- generates and processes insurance claims

Health Information Management

- supports the operational needs of the modern medical records department including transcription, case indexing/abstracting and statistical reporting
- tracks deficiencies in a patient's chart and provides chart location information

Patient Index

- maintains a master index of hospital patients and provides immediate online access to patient financial and medical data associated with a patient stay

Electronic Claims Processing

- provides a computer-to-computer link with intermediaries for Medicare and other payers for the submission of claims

Medical Practice Management

- supports patient account management and insurance processing for single and multiple practices/clinics
- supports both hospital-based and remote practices/clinics

We also offer the following optional products that may be purchased as part of our core patient management suite:

Scheduling

- maintains all patient scheduling information

Managed Care

- tracks patients enrolled in managed care plans and conforms billing functions to such plans

Quality Improvement

- automates hospital-wide total quality management and reporting requirements for utilization activity, risk management, infection surveillance and all accreditation review functions

Financial Accounting. Our financial accounting software provides a variety of business office applications designed to efficiently track and coordinate information needed for managerial decision-making. Our financial accounting software:

Executive Information System

- summarizes daily financial transactions regarding patient revenues, receipts, census statistics and billing information for ready access by hospital administrators

General Ledger

- provides timely, accurate, financial information generated from daily hospital operations
- formats financial statements to the specifications of each user and is able to generate up to 999 different user-defined reports

Accounts Payable

- processes vendor invoices and payments and their related general ledger entries

Payroll/Personnel

- calculates all employee wages and benefits for an unlimited number of salaried and hourly employees
- allocates employee time to user-defined cost centers

Time and Attendance

- uses touch screen time clocks to eliminate manual time entry
- reduces effort of gathering employee time data and increases access of managers to such data
- makes time records more accurate by identifying employees through bar-coding and optional biometric fingerprint technology

<i>Electronic Direct Deposits</i>	<ul style="list-style-type: none"> • provides for computerized bank deposits to meet payroll and accounts payable needs
<i>Human Resources</i>	<ul style="list-style-type: none"> • provides for computerized employee files through document/image scanning and data entry • allows for complete tracking of benefits and other employee data through a variety of user-defined reports • tracks job applicant information to assist in the employee recruiting and hiring process
<i>Budgeting</i>	<ul style="list-style-type: none"> • allows for complete on-line budget preparation through computerized access to historical data
<i>Fixed Assets</i>	<ul style="list-style-type: none"> • allows access to information regarding hospital assets including locations and depreciation scheduling
<i>Materials Management</i>	<ul style="list-style-type: none"> • tracks the flow of materials throughout the hospital • automates the process of inventory control, materials purchasing, stock requisitions and patient charging

Clinical. Our clinical software automates record keeping and reporting for many clinical functions including laboratory, radiology, physical therapy, respiratory care, and pharmacy. These products eliminate tedious paperwork, calculations and written documentation while allowing for easy retrieval of patient data and statistics. Our clinical software:

<i>Laboratory Information Systems</i>	<ul style="list-style-type: none"> • provides an interface to laboratory analytical instruments in order to transfer results to nurse stations, mobile point-of-care systems and remote physician offices • allows users to receive orders from any designated location, process orders and report results and maintain technical, statistical and account information
<i>Laboratory Instrument Interfaces</i>	<ul style="list-style-type: none"> • provides an automated solution for reviewing test results and completing patient orders • reduces the amount of required manual data entry thereby reducing the likelihood of human error • reduces time to process laboratory specimens
<i>Radiology Information Systems</i>	<ul style="list-style-type: none"> • includes flash card printing, patient scheduling, transcription, patient indexing by X-Ray film number, film tracking and location • receives patient data, patient locations and other interdepartmental communications support

ImageLink™

- provides a complete picture archiving and communications system (PACS) with comprehensive functionality designed to fit seamlessly with our other applications
- allows the realization of an electronic medical record complete with diagnostic images
- provides physicians real time access to diagnostic images via the internet through ChartLink™

Physical Therapy and Respiratory Care

- communicates to nursing the appropriate procedures and patient preparation instructions from orders entered into the CPSI system
- keeps a journal of the orders received and processed
- handles a variety of processing tasks after a patient order is reviewed
- allows a department to customize its results to be sent back to nursing

Pharmacy

- allows the hospital pharmacist to enter and fill physician orders
- performs all of the functions related to patient charging, general ledger upgrading, re-supply scheduling and inventory reduction/statistics maintenance
- improves patient care by monitoring drug/drug and food/drug interactions, allergy contraindications, dosage ranges and duplicate therapy
- produces drug education information for each patient in an easy-to-read format

Patient Care. Our patient care applications allow hospitals to create computerized "patient files" in place of the traditional paper file systems. This software enables physicians, nurses and other hospital staff to improve the quality of patient care through increased access to patient information, assistance with projected care requirements and feedback regarding patient needs. Our software also addresses current safety initiatives in the healthcare industry such as the transition from written prescriptions and physician orders to computerized physician order entry. Our patient care software:

Order Entry / Results Reporting

- automates the entry of patient charges
- reduces "lost" charges and mistakes due to legibility
- increases efficiency of nursing stations
- provides interactive, real time status reports for orders

Point-of-Care System

- allows nurses to enter patient data into the network at the patient's bedside thereby eliminating the duplicate entry of information
- utilizes touch-screen and wireless technology
- makes patient information instantly available throughout the entire hospital system

Patient Acuity

- categorizes patients according to an assessment of the acuity of the illness, severity of the symptoms, and projected nursing dependency
- allows nurses to project the total character and amount of care that should be provided to each patient

ChartLink™

- provides physicians with secure and interactive access to patient information through a hospital's website
- provides for computerized physician order entry including medication order entry

Medication Verification

- verifies the accuracy of patient medication orders at a patient's bedside by comparing scans of patient and medication bar codes against the medication orders and history for that patient
- screens medication orders for possible patient allergies and/or drug interactions

Resident Assessment Instruments

- allows nursing staff to complete time consuming resident reporting requirements in an expeditious and efficient manner
- generates nursing care plans based on deficiencies in the resident reports

Medical Practice Charting

- provides a permanent electronic encounter record for the physician office
- provides patient charting customized to the specific needs of each practice

Medical Practice Access

- provides physicians and their office administrators with remote access to online, real time, secure patient data such as insurance and billing information, diagnosis and procedure coding, discharge summaries, pharmacy profiles and other clinical and administrative information

Enterprise Applications. We provide software applications that support the products described above and are useful to all areas of the hospital. These applications include: ad hoc reporting, automatic batch and real-time system backups, an integrated fax system, archival data repository, document scanning and Microsoft Office integration.

Home Health Information System. We offer a comprehensive information system for use in home healthcare, which system incorporates certain of the applications described above. This system is

used primarily by hospitals with a CPSI information system that also have home health departments. Our home health system provides an advanced solution that includes both home care patient accounting/billing and remote home care documentation and care tracking. The system is designed, developed and regularly enhanced to meet the needs and regulatory requirements that challenge home healthcare.

Support and Maintenance Services

After a customer installs a CPSI system, we provide software application support, hardware maintenance, continuing education and related services pursuant to a support agreement. The following describes services provided to customers using CPSI systems.

Total System Support. We believe the quality of continuing customer support is one of the most critical considerations in the selection of an information system provider. We provide hardware, technical and software support for all aspects of our system which gives us the flexibility to take the necessary course of action to resolve any issue. Unlike our competitors who use third-party services for hardware and software support, we provide a single, convenient and efficient resource for all of our customers' system support needs. In order to minimize the impact of a system problem, we train our customer service personnel to be technically proficient, courteous and prompt. Because a properly functioning information system is crucial to a hospital's operations, our support teams are available 24 hours a day to assist customers with any problem that may arise. Customers can also use the Internet to directly access our support system. This allows customers to communicate electronically with our support teams at any time. With approximately 563 employees who provide customer service and support, we currently have a greater than one to one support staff to customer ratio.

User Group. All of our customers are members of our user group from which we solicit feedback regarding our products. We host a national user group meeting annually. We have also organized several active regional user groups which meet on a semi-annual basis. These groups meet to discuss and recommend product modifications and improvements which they then evaluate and prioritize. Upon confirming that the desired improvements are technically feasible, we agree to allocate a significant amount of programming time each year to undertake the requested modification or improvement. The majority of our product enhancements originate from suggestions from our customers through the user group structure.

Software Releases. We are committed to providing our customers with software and technology solutions that will continue to meet their information system needs. To accomplish this purpose, we continually work to enhance and improve our application programs. As part of this effort, we typically release two software updates each year at no additional cost to our customers. We design these enhancements to be seamlessly integrated into each customer's existing CPSI system. The benefit of these enhancements is that each customer, regardless of its original installation date, uses the most advanced CPSI software available. Through this process, we can keep our customers up-to-date with the latest operational innovations in the healthcare industry as well as changing governmental regulatory requirements. Another benefit of this "one system" concept is that our customer service teams can be more effective in responding to customer needs because they maintain a complete understanding of and familiarity with the one system that all customers use.

Purchasing a new information technology system requires the expenditure of a substantial amount of capital and other resources, and many customers are concerned that these systems will become obsolete as technology changes. Our periodic product updates eliminate our customers' concerns about system obsolescence. We believe providing this benefit is a strong incentive for potential customers to select our products over the products of our competitors.

Hardware Replacement. As part of our customer service effort, we are also committed to promptly replacing malfunctioning system hardware in order to minimize the effect of operational interruptions. By providing all hardware used in our system, we believe we are better able to meet and address all of the information technology needs of our customers.

Application Service Provider. In some circumstances, we offer ASP services to customers via remote access telecommunications. As an application service provider, we store and maintain computer servers dedicated to specific customers which contain all of such customers' critical patient and administrative data. These customers access this information remotely through direct telecommunications connections with these servers.

Internet Service Provider. As part of our total information solution, we can provide Internet connection services to our customers. We also can provide web-site design and hosting services.

Forms and Supplies. We offer our customers the forms that they need for their patient and financial records, as well as their general office supplies. Furnishing these forms and supplies helps us to achieve our objective of being a one-source solution for a hospital's complete healthcare information system requirements.

Outsourcing Services

Electronic Billing. We provide electronic billing for customers at prices competitive with other electronic billing vendors. Once a customer processes patient insurance claims in our system, we then perform the electronic billing function with no other participation by hospital staff. With this service, customers need not prepare billing files or maintain interfaces with third-party software, thereby saving the customer both time and money.

Statement Processing. Our customers may choose to have us prepare and distribute all patient billing statements. We use our knowledge of a customer's collection system to produce statements without requiring any actions on the part of the hospital data processing personnel. Because we can connect directly with a customer's system, the customer is not required to build and transfer files to us. All system enhancements are incorporated into the statement process without having to modify any third-party vendor interface. Like the electronic billing outsourcing, this service saves the customer both time and money.

Business Office Outsourcing. We offer customers the option of using us to perform their primary business office functions, including patient billing and accounts receivable management. Using this service allows customers to reduce costs by employing fewer full time administrative employees.

System Implementation and Training

Conversion Services. When a customer purchases our system, we convert its existing data to the CPSI system. Our knowledge of hospital data processing, in conjunction with extensive in-house technical expertise, allows us to accomplish this task in a cost effective manner. When we install a new system, the data conversion has already occurred so that the system is immediately operational. Our goal is for each customer to be immediately productive in order not to waste time and money on the costly and inefficient task of maintaining the same data on parallel systems. Our services also relieve the hospital staff of the time-consuming burden of data conversion.

Training. In order to integrate the new system and to ensure its success, we spend approximately three weeks providing individualized training on-site at each customer's facility at the time of installation. We directly train all hospital users, including staff members and healthcare providers, during all hospital shifts in the use of hardware and software applications. In contrast, some of our

competitors train only a hospital's training staff at an off-site location. We employ nurses and medical technicians in addition to our technical training staff in order to help us communicate more effectively with our customers during the training process.

Technology

Operating Systems and Server Platform. We utilize Intel-based servers running industry standard "open systems," including Unix and Microsoft Windows 2000 Server operating systems.

ClientWare® Networking. Our ClientWare® application integrates the UNIX and Microsoft operating systems. This integration brings together the strengths of both operating environments. The processing power of UNIX combined with the communication capabilities of Microsoft Windows creates an information system that allows the use of familiar "point and click" processing. This architecture also facilitates integration of other Microsoft software and provides expanded opportunities for the inclusion of new technologies without sacrificing system reliability or performance.

Wireless Technology. Traditional workstations were designed around access to electrical and network outlets. We now use wireless networking technology to connect computers to the CPSI system. This allows customers to use mobile computers and to place stationary computers in locations for optimum convenience and ease of use. We incorporate wireless laptop and hand held computers into our system. Convenient to carry and use, these mobile computers allow effective data collection and real-time access to patient information from practically anywhere in the hospital. Information efficiently collected will then be more quickly accessible by other caregivers throughout the hospital.

Point-of-Care Stations. Since 1990, we have used "point-of-care stations" which allow nurses to enter information into the system at a patient's bedside. These stations consist of compact computers on individual data entry stations that are lightweight, durable and easy to maneuver. We incorporate our wireless networking capabilities into these stations in order to provide extended range and mobility.

Touch Sensitive Displays. Data entry is made easier through the use of touch sensitive displays. With this technology work areas are free of the traditional keyboard and mouse associated with most personal computers. Touch screens are also more efficient for users who are not proficient in computer skills.

Voice Transcription. We offer voice transcription software capable of learning an individual physician's speech patterns. Computerized transcription stations can then transcribe documents dictated by physicians. The resulting reduction in time required to input patient data and prepare patient documents positively impacts the quality of patient care by providing caregivers with faster access to the most up-to-date patient information.

Biometric Recognition. As unique as each individual, a fingerprint cannot be duplicated, making it one of the most secure methods of verifying a person's identity. Because of the sensitivity of healthcare information and proposed federal security requirements, we have incorporated licensed fingerprint identification technology as an option for our systems. When a user signs on to the system, he or she must scan his or her fingerprint as well as enter a traditional password. The system rapidly responds with the confirmation or rejection of the user's identity.

Research and Development

We are continually working to improve and enhance the CPSI system and to develop new products and services for our system. The primary source of ideas for improvements to our products and services comes from our customers through our national user group. We believe our interaction with customers and their communication with each other is the most efficient way to learn about and respond

to changes in the healthcare operating environment. This approach to research and development allows us to quickly adapt to technology advances and improve our products and services to better serve the needs of our customers. Our management and customer support and service teams play a significant role in product development by continually monitoring the needs and desires of our customers and our market. In addition to our customer support and service teams, we currently have five employees whose primary function is the development of financial and enterprise software products and ten employees whose primary function is the development of clinical software products. Finally, we currently have eight research and development employees whose dedicated function is to develop new uses for and applications of technology available in the marketplace.

Customers, Sales and Marketing

Target Market. The target market for our information system consists of small and midsize hospitals of 300 or fewer acute care beds. In the United States, there are approximately 4,100 hospitals in this size range. In addition, we market our products to small specialty hospitals in the United States that focus on discrete medical areas such as surgery, rehabilitation and psychiatry. As of February 28, 2005, we had installed our system in 530 facilities in 45 states and the District of Columbia. Approximately 92% of our existing customers are hospitals with 100 or fewer acute care beds, while approximately 99% of our existing customers are hospitals with 200 or fewer acute care beds. Our goal is to increase sales to hospitals with 100 to 300 acute care beds while maintaining our competitive position in the under 100 bed market segment.

Sales Staff. Most of our new customers are referrals from our existing customers, thereby reducing the need for a large sales force. Currently, we have 18 employees dedicated to direct sales, eight of whom concentrate on new prospects, and ten of whom are responsible for the sale of additional products and services to existing customers. We hire our sales representatives from our existing employees. Our current sales representatives have an average of 10.7 years of prior experience in installation, training and customer support. While centrally based at our headquarters in Mobile, our sales representatives have defined geographic territories in the United States in which to target new customers. A significant portion of the compensation for all sales personnel is performance based.

Marketing Strategy. Our primary marketing strategy is to generate referrals from our existing customers and directly solicit potential users through presentations at industry seminars and trade shows. We also advertise in various healthcare industry trade publications. For hospitals that we have targeted as potential customers, most of our direct sales efforts involve site visits and meetings with hospital management. The typical sales cycle of a healthcare information system usually takes six to eighteen months from the time of initial contact to the signing of a contract. Therefore, we believe it is important for our sales staff to dedicate a substantial amount of time and energy to building relationships with potential new customers. We do not conduct extensive marketing activities and promotions because hospitals are easily identified, finite in number and generally send a request for proposal to vendors when they contemplate the purchase of a hospital information system.

Competition

The market for our products and services is competitive, and we expect additional competition from established and emerging companies in the future. Our market is characterized by rapidly changing technology, evolving user needs and the frequent introduction of new products. We believe the principal competitive factors that hospitals consider when choosing between us and our competitors are:

- product features, functionality and performance;
- level of customer service and satisfaction;

- ease of integration and speed of implementation;
- product price;
- knowledge of the healthcare industry;
- sales and marketing efforts; and
- company reputation.

Our principal competitors are Medical Information Technology, Inc., or "Meditech," and Healthcare Management Systems, Inc., or "HMS." Meditech and HMS compete with us directly in our target market of small and midsize hospitals. These companies offer products and systems that are comparable to our system and address the needs of hospitals in the markets we serve.

Our secondary competitors include McKesson Corporation, Quadramed Corp., Cerner Corporation and Siemens Corporation. These companies are significantly larger than we are, and they typically sell their products and services to larger hospitals outside of our target market. However, they will sometimes compete directly with us. We also face competition from providers of practice management systems, general decision support and database systems and other segment-specific applications, as well as from healthcare technology consultants. Any of these companies as well as other technology or healthcare companies could decide at any time to specifically target hospitals within our target market.

A number of existing and potential competitors are more established than we are and have greater name recognition and financial, technical and marketing resources than we have. Products of our competitors may have better performance, lower prices and broader market acceptance than our products. We expect that competition will continue to increase.

Internal Management Control System

We have developed and maintain an automated enterprise management system which permits us to manage not only all of our internal management, accounting and personnel functions, but also all information relating to each customer's information system. Our system maintains detailed records of all information regarding each customer's system, including all system specifications, service history and customer communications, among other things. This internal control system helps us to more effectively respond to customer support needs through complete and current system information and through situation-based problem solving.

Intellectual Property

We regard some aspects of our internal operations, software and documentation as proprietary, and rely primarily on a combination of contract and trade secret laws to protect our proprietary information. We believe, because of the rapid pace of technological change in the computer software industry, trade secret and copyright protection is less significant than factors such as the knowledge, ability and experience of our employees, frequent software product enhancements and the timeliness and quality of support services. We cannot guarantee that these protections will be adequate or that our competitors will not independently develop technologies that are substantially equivalent or superior to our technology.

We do not believe our software products or other CPSI proprietary rights infringe on the property rights of third parties. However, we cannot guarantee that third-parties will not assert infringement claims

against us with respect to current or future software products or that any such assertion may not require us to enter into royalty arrangements or result in costly litigation.

Employees

As of February 28, 2005, we had 763 employees, all but four of whom are located at our offices in Mobile, Alabama. Our employees can be grouped according to the following general categories: 490 in financial and clinical software services and support, 114 in information technology services and support, 72 in programming, 30 in sales and marketing and 34 in administration. We have 23 employees who perform research and development activities. These employees are included within the functional areas of financial and clinical software services and support and information technology services and support. Our general practice is to recruit recent college graduates for entry-level positions and then promote these individuals within the organization to fill vacancies in higher positions. We also hire nurses and other medically-trained professionals in connection with our support services.

Since 1991, we have maintained a non-qualified profit sharing plan under which all full-time employees with three years of uninterrupted service are eligible to participate, other than executive officers and commissioned salespeople. The plan is designed to provide each eligible employee with periodic cash bonuses based on our profitability. Each eligible employee receives a pro rata share of the amount of cash distributed under the profit sharing plan based on the amount of their base salary compared to the sum of the salaries of all participating employees. Our profit sharing plan is not a qualified plan for tax purposes or a guaranteed benefit. Contributions to the plan are made periodically at the discretion of the Board of Directors. During 2004, we distributed approximately \$1.0 million under this profit sharing plan. We plan to continue to make distributions under the profit sharing plan based on our profitability.

We are fortunate to have a high rate of employee retention, with our senior management having an average tenure in excess of 14 years. Our performance depends in significant part on our ability to attract, train and retain highly qualified personnel. None of our employees are represented by a labor union, and we believe our relations with our employees are good.

Executive Officers

The Executive Officers of CPSI serve at the pleasure of the Board of Directors. Set forth below is a list of the current Executive Officers of CPSI and a brief explanation of their principal employment during the last five (5) years.

David A. Dye – President and Chief Executive Officer. David A. Dye, age 35, has served as our President and Chief Executive Officer since July 1999. He was elected as a director in March 2002. Mr. Dye began his career with us in May 1990 as a Financial Software Support Representative. From that time until June 1999, he worked for us in various capacities, including as Manager of Financial Software Support, Director of Information Technology and most recently as our Vice President supervising the areas of sales, marketing and information technology.

J. Boyd Douglas – Executive Vice President and Chief Operating Officer. J. Boyd Douglas, age 38, has served as our Executive Vice President and Chief Operating Officer since July 1999. He was elected as a director in March 2002. Mr. Douglas began his career with us in August 1988 as a Financial Software Support Representative. From May 1990 until November 1994, Mr. Douglas served as Manager of Electronic Billing, and from December 1994 until June 1999, he held the position of Director of Programming Services.

M. Stephen Walker – Vice President--Finance, Chief Financial Officer, Secretary and Treasurer. M. Stephen Walker, age 55, has served as our Vice President--Finance, Chief Financial

Officer, Secretary and Treasurer since July 1999. From February 1991 until June 1999, Mr. Walker served as our controller with primary responsibility for all of our accounting functions.

Victor S. Schneider – Vice President--Sales and Marketing. Victor S. Schneider, age 46, has served as our Vice President--Sales and Marketing since July 1999. Mr. Schneider is responsible for overseeing all of our sales and marketing efforts. Mr. Schneider began his career with us in June 1983 as Sales Manager. He served in that capacity until January 1997 when he was promoted to Sales Director.

Robert D. Hinckle – Vice President--Financial Software Services. Robert D. Hinckle, age 35, has served as our Vice President--Financial Software Services since October 2004. Mr. Hinckle is responsible for overseeing all aspects of the installation and support of our financial software products. Since beginning his career with us in 1995 as a Financial Software Support Representative, Mr. Hinckle has worked in various positions in our Financial Software Services Division including Team Manager, Assistant Director and Director of that division.

Thomas W. Peterson – Vice President--Clinical Software Services. Mr. Peterson, age 53, has served as our Vice President--Clinical Software Services since July 1999. Mr. Peterson is responsible for overseeing all aspects of the installation and support of our clinical software products. Since beginning his career with us in 1988 as a Clinical Software Support Representative, Mr. Peterson has worked in various positions in our Clinical Software Services Division including Manager and Director of that division.

Patrick A. Immel – Vice President--Information Technology Services. Patrick A. Immel, age 34, has served as our Vice President--Information Technology Services since January 2000. Mr. Immel is responsible for overseeing technical hardware and support and hardware research and development. Mr. Immel began his career with us in July 1993 as a Financial Software Support Representative. Since that time, Mr. Immel has served as a programmer, Manager of Technical Support and most recently as Director of Information Technology Services.

Company Website

The Company maintains a website at <http://www.cpsinet.com>. The Company makes available on its website, free of charge, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports, as soon as it is reasonably practicable after such material is electronically filed with the Securities and Exchange Commission. The Company is not including the information contained on or available through its website as a part of, or incorporating such information into, this Annual Report on Form 10-K.

ITEM 2. PROPERTIES

Our corporate headquarters and executive offices are located on approximately 28 acres in Mobile, Alabama. We occupy approximately 123,500 square feet of space in eleven buildings. Our main building consists of approximately 66,000 square feet of space. We also have nine additional buildings each consisting of approximately 6,000 square feet. Each of these smaller buildings is designed to accommodate a team of employees assigned to install and support a particular software application. We also occupy a building consisting of approximately 3,500 square feet of space which houses our eight research and development employees dedicated to developing new uses for and applications of available technology.

We lease approximately 16.5 acres and all of our buildings (other than the research and development building) from CP Investments, Inc., an Alabama corporation, the stockholders of which are John Morrissey, John Heyer, Bob O'Donnell, Elissa Stillings, Kevin P. Wilkins, Tabitha M. Wilkins Olzinski, Ellen M. Harvey, Michael K. Muscat, Jr. and Susan M. Slaton. All of these individuals are either stockholders of CPSI, or, in the case of Ms. Stillings, the spouse of a stockholder. Our leases with

CP Investments, Inc. expire at various times between April 2012 and March 2015. The research and development building is leased from DJK, LLC, a limited liability company owned by Dennis Wilkins, a principal stockholder and a director of CPSI. Our lease with DJK, LLC also expires in April 2012. We also own 11.3 acres of undeveloped real property adjacent to our primary premises in order to accommodate future growth.

We believe our existing facilities will be sufficient to meet our needs until the second half of 2005. At that time we believe we will need to construct additional facilities on the undeveloped portion of our campus in order to accommodate our expansion needs.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are involved in routine litigation that arises in the ordinary course of business. We currently are involved in a litigated dispute relating to the installation of a hospital information system that, if resolved unfavorably, could have a negative impact on our quarterly earnings at some point in the future. However, this dispute should not have a material adverse effect on our business or financial condition. We are not currently involved in any other litigation that we believe could reasonably be expected to have a material adverse effect on our business, financial condition or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY-HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market for CPSI Common Stock

At March 11, 2005, CPSI had 89 stockholders of record (which does not include the number of beneficial owners whose shares are held in "street" names by nominees who are record holders) and 10,489,849 shares of common stock outstanding.

CPSI common stock is traded in the over-the-counter market and prices are quoted on the NASDAQ National Market under the symbol "CPSI." The following table sets forth, for the calendar quarters indicated, the high and low sales prices per share for CPSI's common stock on the NASDAQ National Market, and the cash dividends declared per share in each such quarter:

	<u>High</u>	<u>Low</u>	<u>Dividends Declared Per Share</u>
2003			
First Quarter	\$25.93	\$20.78	--
Second Quarter	25.05	17.80	\$0.085
Third Quarter	21.75	14.04	0.085
Fourth Quarter	20.35	14.40	0.085
2004			
First Quarter	\$22.00	\$16.75	\$0.120
Second Quarter	21.25	17.69	0.120
Third Quarter	21.58	17.39	0.120
Fourth Quarter	23.63	19.90	0.120

The last reported sales price of CPSI's common stock as reported on the NASDAQ Stock Market on March 11, 2005 was \$25.82.

Dividends

During 2002, we paid a total of \$16.9 million to our pre-IPO stockholders in connection with our initial public offering ("IPO"), which was completed in May 2002, and our related conversion from an S corporation to a C corporation. During 2003, we paid an additional \$250,000 to these pre-IPO stockholders.

During the second quarter of 2003, we paid our first dividend on our common stock to our post-IPO stockholders. In the second, third and fourth quarters of 2003, we paid a dividend in the amount of \$0.085 per share. During 2004, we paid a quarterly dividend in the amount of \$0.12 per share. On February 1, 2005, we announced a dividend for the first quarter of 2005 in the amount of \$0.22 per share. We believe that paying dividends is an effective way of providing an investment return to our stockholders and a beneficial use of our cash.

With respect to information regarding our securities authorized for issuance under equity incentive plans, the information contained in the section entitled "Equity Compensation Plan Information" of CPSI's definitive Proxy Statement for the 2005 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A is incorporated herein by reference pursuant to General Instruction G(2) of Form 10-K.

ITEM 6. SELECTED FINANCIAL DATA

	Year ended December 31,				
	2004	2003	2002	2001	2000
INCOME DATA:					
			(in thousands except for share and per share data)		
Total sales revenues	\$ 82,664	\$ 81,303	\$ 73,744	\$ 59,666	\$ 49,222
Total costs of sales	49,576	48,405	42,925	36,242	31,487
Gross profit	33,088	32,898	30,819	23,424	17,735
Total operating expenses	21,886	20,352	18,750	14,948	13,080
Operating income	11,202	12,546	12,069	8,476	4,655
Total other income	501	338	552	204	236
Income before taxes	11,703	12,884	12,621	8,680	4,891
Income taxes	4,639	5,018	1,971	-	-
Net income (1)	\$ 7,064	\$ 7,866	\$ 10,650	\$ 8,680	\$ 4,891
Net income per share - basic	\$ 0.67	\$ 0.75	\$ 1.06	\$ 0.93	\$ 0.53
Net income per share - diluted	\$ 0.67	\$ 0.75	\$ 1.06	\$ 0.93	\$ 0.53
Weighted average shares outstanding:					
Basic	10,489,849	10,488,406	10,024,438	9,288,000	9,288,000
Diluted	10,535,555	10,536,929	10,061,765	9,288,000	9,288,000
Pro forma income data: (2)					
Historical income before provision for income taxes			\$ 12,621	\$ 8,680	\$ 4,891
Pro forma income taxes			4,577	3,231	1,826
Pro forma net income			\$ 8,044	\$ 5,449	\$ 3,065
Pro forma net income per share - basic			\$ 0.80	\$ 0.59	\$ 0.33
Pro forma net income per share - diluted			\$ 0.80	\$ 0.59	\$ 0.33

	As of December 31,				
	2004	2003	2002	2001	2000
BALANCE SHEET DATA					
			(in thousands)		
Cash and cash equivalents	\$ 13,785	\$ 9,473	\$ 6,352	\$ 2,019	\$ 1,033
Working capital	22,480	19,676	14,812	5,667	4,658
Total assets	36,078	31,270	28,909	17,251	14,515
Total current liabilities	7,526	5,452	8,430	6,551	5,810
Note payable	-	-	-	664	749
Total stockholders' equity	27,834	25,752	20,479	10,036	7,956

- (1) CPSI operated as an S corporation through May 20, 2002 and, as such, was not subject to federal and certain state income taxes.
- (2) Pro forma information reflects the provision for income taxes that would have been recorded had CPSI been a C corporation during all of the periods presented.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion of our financial condition and results of operations in conjunction with "Selected Financial Data" and our financial statements and the related notes included elsewhere in this Annual Report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those set forth under "Risk Factors" and elsewhere in this Annual Report.

Background

CPSI was founded in 1979 and specializes in delivering comprehensive healthcare information systems and related services to community hospitals. Our systems and services are designed to support the primary functional areas of a hospital and to enhance access to needed financial and clinical information. Our comprehensive system enables healthcare providers to improve clinical, financial and administrative outcomes. Our products and services provide solutions in key areas, including patient management, financial management, patient care and clinical, enterprise and office automation. In addition to servicing small to medium-sized hospitals, we provide information technology services to other related entities in the healthcare industry, such as nursing homes, home health agencies and physician clinics.

We sell a fully integrated, enterprise-wide financial and clinical hospital information system comprised of all necessary software, hardware, peripherals, forms and office supplies, together with comprehensive customer service and support. We also offer outsourcing services, including electronic billing submissions, patient statement processing and business office functions, as part of our overall information system solution. We believe that as our customer base grows, the demand for our outsourcing services will also continue to grow, supporting further increases in recurring revenues.

Our system currently is installed and operating in over 530 hospitals in 45 states and the District of Columbia. Our customers consist of community hospitals with 300 or fewer acute care beds, with hospitals having 100 or fewer acute care beds comprising approximately 92% of our customers.

Overview

We have achieved a compounded annual growth rate in revenues of approximately 10.4% over the past five years. While we did not achieve this growth rate in 2004, we experienced a steady improvement in revenues and margins during each quarter of 2004. 2004 was a notably difficult year financially for community hospitals for several reasons, including a weak Medicare and Medicaid reimbursement environment during much of the first half of the year, high salary costs due to a nationwide shortage of clinical professionals such as nurses and pharmacists, and lower than anticipated patient admissions. The difficult year for our target market led to a challenging year for CPSI. During the first several months of 2004, many hospitals delayed making significant information technology purchases due to lack of available capital.

We added 40 new hospital clients in 2004; however, during the first quarter of 2004, as in most of 2003, many hospitals approved purchases for the minimum amount of software needed to begin the installation of an integrated system. Nevertheless, there was an increasing trend among our hospital clients, particularly during the latter half of 2004, to purchase comprehensive systems from us. Accordingly, the size of our average installation contract increased from approximately \$500,000 in 2003 to approximately \$635,000 in 2004, approaching the size of our average installation contract in 2002 of \$650,000.

Our gross revenues increased 1.7% over 2003, while our net income decreased 10.7%, principally as a result of the financial difficulties faced by community hospitals during much of 2004. However, cash flow from operations and total cash collections increased in 2004 and reached record levels of \$11.1 million and \$83.9 million, respectively. We continue to believe that our strong cash performance reflects both the quality of our customer service and our conservative revenue recognition practices.

As a result of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (2003 Medicare Act), community hospitals began experiencing improved Medicare reimbursement starting in April 2004, the month in which the 2003 Medicare Act became effective. In the past, Medicare's payment formula had created a disproportionate burden on smaller, community-based hospitals, which also typically depend on Medicare for a greater share of their payer mix than larger, urban facilities. The 2003 Medicare Act rectifies some of this imbalance, raising Medicare reimbursements to rural hospitals by an estimated \$25 billion over the next ten years. We believe this legislation will remove one of the primary obstacles to community hospitals' investing in healthcare information technology. Many of these hospitals had postponed or substantially limited such investments prior to the effectiveness of the 2003 Medicare Act. Accordingly, we believe that the financial effects of this legislation on community hospitals will have a positive impact on our financial results and will put us in a good position to continue to grow our business. Our improving results throughout 2004 support the confidence we have in our business, our target market and the quality of the products and services we offer.

Revenues

System Sales. Revenues from system sales are derived from the sale of information systems (including software, conversion and installation services, hardware, peripherals, forms and office supplies) to new customers and from the sale of new or additional products to existing customers. We do not record revenue upon execution of a sales contract. Upon signing a contract to purchase a system from us, each customer pays a non-refundable 10% deposit that is recorded as deferred revenue. The customer pays 40% of the purchase price for the software and the related installation, training and conversion when we install the system and commence training on-site at the customer's facility, which is likewise recorded as deferred revenue. When the system begins operating in a live environment, the remaining 50% of the system purchase price is payable, and we recognize revenue for the total amount of the purchase price for software and related services. Revenues derived from installation of additional software applications are generally recognized upon installation. Revenues from the sale of hardware, forms and supplies are recognized upon the shipment of the product to the customer.

Support and Maintenance. We also derive revenues from the provision of system support services, including software application support, hardware maintenance, continuing education and related services. Support services are provided pursuant to a support agreement under which we provide comprehensive system support and related services in exchange for a monthly fee based on the services provided. The initial term of these contracts ranges from one to seven years, with a typical duration of five years. Upon expiration of the initial term, these contracts renew automatically from year-to-year thereafter until terminated. Revenues from support services are recognized in the month when these services are performed.

We provide our products to some customers as an application service provider, or "ASP." We provide ASP services on a remote access basis by storing and maintaining servers at our headquarters which contain customers' patient and administrative data. These customers then access this data remotely in exchange for a monthly fee. In addition, as part of our total information solution, we serve as an Internet service provider, or "ISP," for some of our customers for a monthly fee. We also provide web-site design and hosting services if needed. Revenues from our ASP and ISP services are recognized in the month when these services are delivered.

Outsourcing Revenues. We began offering outsourcing services in January 1999. Revenues from outsourcing services have continued to increase since that time, and we expect that the rate of growth in our outsourcing revenues will increase in the foreseeable future based on the current demand for these services. Our outsourcing services include electronic billing, statement processing and business office outsourcing (primarily accounts receivable management). Most of these outsourcing services are sold pursuant to one year customer agreements, with automatic one year renewals until terminated. Revenues from outsourcing services are recognized when these services are performed.

Costs of Sales

System Sales. The principal costs associated with the design, development, sale and installation of our systems are employee salaries, benefits, travel expenses and certain other overhead expenses. For the sale of equipment we incur costs to acquire these products from the respective distributors or manufacturers, as the case may be. Costs are deferred and recognized as an expense at the time the related revenues are recognized. However, at December 31, 2004, 2003 and 2002, no system sales related costs were deferred, as all contracts were deemed to be substantially complete, or such amounts were not considered to be material.

Support and Maintenance. The principal costs associated with our system support and maintenance services are employee salaries, benefits and certain other overhead expenses. Costs are expensed as incurred and are not deferred.

We have the same employee groups providing both system installations and support and maintenance services. Salary related expenses are allocated between cost of system sales and cost of support and maintenance services based upon an estimate of the percentage of time employees spend performing each function.

Outsourcing. The principal cost related to our statement outsourcing is postage. The principal costs related to our electronic billing outsourcing are employee related expenses, such as salaries and benefits, and long distance telecommunication fees. Supplies and forms represent an additional cost associated with our outsourcing services. Costs are expensed as incurred and are not deferred.

Results of Operations

The following table sets forth certain items included in our results of operations for each of the three years in the period ended December 31, 2004, expressed as a percentage of our total revenues for these periods (dollar amounts in thousands):

	Year ended December 31,					
	2004		2003		2002	
	Amount	% Sales	Amount	% Sales	Amount	% Sales
INCOME DATA:						
Sales revenues:						
System sales	\$ 35,252	42.6%	\$ 39,708	48.9%	\$ 38,309	51.9%
Support and maintenance	38,010	46.0%	34,567	42.5%	30,246	41.0%
Outsourcing	9,402	11.4%	7,028	8.6%	5,189	7.1%
Total sales revenues	82,664	100.0%	81,303	100.0%	73,744	100.0%
Costs of sales:						
System sales	27,064	32.7%	28,045	34.5%	25,838	35.0%
Support and maintenance	16,916	20.5%	16,101	19.8%	13,905	18.9%
Outsourcing	5,596	6.8%	4,259	5.2%	3,182	4.3%
Total costs of sales	49,576	60.0%	48,405	59.5%	42,925	58.2%
Gross profit	33,088	40.0%	32,898	40.5%	30,819	41.8%
Operating expenses:						
Sales and marketing	6,055	7.3%	6,125	7.5%	5,933	8.0%
General and administrative	15,831	19.2%	14,227	17.5%	12,817	17.4%
Total operating expenses	21,886	26.5%	20,352	25.0%	18,750	25.4%
Operating income	11,202	13.5%	12,546	15.5%	12,069	16.4%
Other income (expense):						
Interest income	258	0.3%	216	0.3%	214	0.3%
Miscellaneous income	243	0.3%	122	0.1%	362	0.5%
Interest expense	-	0.0%	-	0.0%	(24)	0.0%
Total other income	501	0.6%	338	0.4%	552	0.8%
Income before taxes	11,703	14.1%	12,884	15.9%	12,621	17.2%
Income taxes	4,639	5.6%	5,018	6.2%	1,971	2.7%
Net income	\$ 7,064	8.5%	\$ 7,866	9.7%	\$ 10,650	14.5%

2004 Compared to 2003

Revenues. Total revenues increased by 1.7% or \$1.4 million to \$82.7 million for 2004 from \$81.3 million for 2003.

System sales revenues decreased by 11.2% or \$4.4 million to \$35.3 million in 2004 from \$39.7 million in 2003. The decrease in system sales revenues was attributable to a decrease in the number of new customer installations and a decrease in the average size of new customer installations. No costs relating to system sales were deferred under our completed contract method of accounting at December 31, 2004 or 2003, as all contracts were deemed to be substantially complete.

Our 11.2% decrease in system sales is less than the 3.7% growth rate we achieved from 2002 to 2003. We experienced slowed growth in system sales revenues during 2004 because of adverse financial conditions affecting community hospitals, including a weak Medicare and Medicaid reimbursement environment, high salary costs due to a nationwide shortage of clinical professionals such as nurses and pharmacists, and lower than anticipated patient admissions. Many hospitals delayed making significant information technology purchases due to lack of available capital. We added 40 new hospital clients in

2004 compared to 48 new hospital clients in 2003. The size of our average installation contract increased in 2004 to approximately \$635,000, from approximately \$500,000 in 2003.

Support and maintenance revenues increased by 10.0%, or \$3.4 million, to \$38.0 million in 2004, from \$34.6 million in 2003. The increase in support and maintenance revenues was attributable to an increase in recurring revenues as a result of a larger customer base. We had over 530 customers at December 31, 2004, compared to 490 at December 31, 2003. ASP services revenues increased by 10.5%, or \$0.3 million, and ISP services revenues remained unchanged.

Outsourcing revenues increased by 33.8%, or \$2.4 million, to \$9.4 million in 2004, from \$7.0 million in 2003. We experienced an increase in outsourcing revenues as a result of continued growth in customer demand for electronic billing and statement outsourcing services. Statement outsourcing revenues increased 13.4% and electronic billing revenues increased 55.0%. Revenue from business outsourcing services increased 73.6%. We were providing business outsourcing services to 16 customers at December 31, 2004, compared to four customers at December 31, 2003.

Costs of Sales. Total costs of sales increased by 2.4%, or \$1.2 million, to \$49.6 million in 2004, from \$48.4 million in 2003. As a percentage of revenues, cost of sales increased to 60.0% for 2004, from 59.5% for 2003.

Cost of system sales decreased by 3.5%, or \$1.0 million, to \$27.0 million for 2004, from \$28.0 million for 2003. This decrease was caused primarily by a decrease in travel expense of \$1.2 million as a result of fewer new hospital installations. Payroll related expenses increased \$0.5 million as a result of increased average employee headcount needed to support increasing sales volume which occurred in the second half of the year. Cost of equipment also decreased by \$0.3 million as a direct result of our decrease in system sales. The gross margin on system sales decreased to 23.2% for 2004, from 29.4% for 2003.

Cost of support and maintenance increased by 5.1%, or \$0.8 million, to \$16.9 million for 2004, from \$16.1 million for 2003. This increase was caused primarily by an increase in depreciation expense of \$0.6 million. Payroll related expenses increased \$0.4 million as a result of increased average employee headcount needed to support our increasing customer base. Also, telecommunication expenses decreased \$0.2 million due to rate adjustments received in 2004. The gross margin on support and maintenance revenues increased to 55.5% for 2004, from 53.4% for 2003. The increase in the gross margin was primarily due to the addition of new customers and with a proportionately smaller increase in support personnel.

Our costs associated with outsourcing services increased 31.4%, or \$1.3 million, to \$5.6 million in 2004, from \$4.3 million in 2003. Salary expense increased \$0.7 million due to the full-year expense of additional employees hired during 2003 and additional employees hired in 2004 to support our business office outsourcing services. Postage costs increased \$0.5 million as a result an increase in transaction volumes of our statement outsourcing services.

Sales and Marketing Expenses. Sales and marketing expenses decreased 1.2%, or \$0.1 million, to \$6.0 million in 2004, from \$6.1 million in 2003. The decrease was attributable to a decrease in advertising expense.

General and Administrative Expenses. General and administrative expenses increased by 11.3%, or \$1.6 million, to \$15.8 million for 2004, from \$14.2 million for 2003. The increase was due primarily to an increase in employee group health insurance of \$0.5 million and salary increases of \$0.3 million. Additional expense increases were \$1.1 million for bad debt, \$0.2 million for taxes and licenses, and \$0.1 million for facilities rent. The increases were offset by a decrease of \$0.5 million in depreciation expense.

As a result of the foregoing factors, income before taxes decreased by 9.2%, or \$1.2 million, to \$11.7 million for 2004, from \$12.9 million for 2003. This growth rate in income before taxes is less than the growth rate we achieved from 2002 to 2003, primarily because of the slower growth in system sales revenues described above.

2003 Compared to 2002

Revenues. Total revenues increased by 10.2%, or \$7.6 million, to \$81.3 million for 2003, from \$73.7 million for 2002.

System sales revenues increased by 3.7%, or \$1.4 million, to \$39.7 million in 2003, from \$38.3 million in 2002. The increase in system sales revenue was attributable to an increase in the number and size of new customer installations. No costs relating to system sales were deferred under our completed contract method of accounting at December 31, 2003 or 2002 as all contracts were deemed to be substantially complete.

Our 3.7% growth rate in system sales is less than the 23.6% growth rate we achieved from 2001 to 2002. We experienced slowed growth in system sales revenues during 2003 because of adverse financial conditions affecting community hospitals, including a weak Medicare and Medicaid reimbursement environment, high salary costs due to a nationwide shortage of clinical professionals such as nurses and pharmacists, and lower than anticipated patient admissions. Many hospitals delayed making significant information technology purchases due to lack of available capital. Although we added a record 48 new hospital clients in 2003, most hospitals approved purchases for the minimum amount of software needed to begin the installation of an integrated system. These smaller purchases caused the size of our average installation contract to decrease from approximately \$650,000 in 2002 to approximately \$500,000 in 2002.

Support and maintenance revenues increased by 14.3%, or \$4.3 million, to \$34.6 million in 2003, from \$30.2 million in 2002. The increase in support and maintenance revenues was attributable to an increase in recurring revenues as a result of a larger customer base, as well as an increase in ASP and ISP services volume. We had 490 customers at December 31, 2003, compared to 444 at December 31, 2002. ASP services revenues increased by 21.4%, or \$0.4 million, and ISP services revenues increased by 20.8%, or \$0.1 million.

Outsourcing revenues increased by 35.4%, or \$1.8 million, to \$7.0 million in 2003, from \$5.2 million in 2002. We experienced an increase in outsourcing revenues as a result of continued growth in customer demand for electronic billing and statement outsourcing services. We initiated business office outsourcing services during the first quarter of 2002 and were providing services to four customers at December 31, 2003.

Costs of Sales. Total costs of sales increased by 12.8%, or \$5.5 million, to \$48.4 million in 2003, from \$42.9 million in 2002. As a percentage of revenues, cost of sales increased to 59.5% for 2003 from 58.2% for 2002.

Cost of system sales increased by 8.5%, or \$2.2 million, to \$28.0 million for 2003, from \$25.8 million for 2002. This increase was caused primarily by an increase in travel expenses of \$0.6 million as a direct result of larger system installations requiring larger installation teams. Additionally, payroll related expenses increased \$1.0 million as a result of increased employee headcount needed to support increasing sales volume. Cost of equipment also increased by \$0.2 million as a direct result of our increase in system sales. The gross margin on system sales decreased to 29.4% for 2003 from 32.6% for 2002.

Cost of support and maintenance increased by 15.8%, or \$2.2 million, to \$16.1 million for 2003, from \$13.9 million for 2002. This increase was caused primarily by an increase in payroll related

expenses of \$1.9 million as a result of increased employee headcount needed to support our increasing customer base. Also, telecommunication expenses increased \$0.1 million due to increased utilization of our ISP services. The gross margin on support and maintenance revenues decreased to 53.4% for 2003 from 54.0% for 2002. The decrease in the gross margin was primarily due to the addition of customer support personnel necessary for the planned expansion of our customer base.

Our costs associated with outsourcing services increased 33.8%, or \$1.1 million, to \$4.3 million in 2003, from \$3.2 million in 2002. Salary expense increased \$0.5 million due to the hiring of additional employees to support our business office outsourcing services. Postage cost increased \$0.5 million as a result of a postal rate increase and an increase in transaction volumes of our statement outsourcing services.

Sales and Marketing Expenses. Sales and marketing expenses increased 3.2%, or \$0.2 million, to \$6.1 million in 2003, from \$5.9 million in 2002. The increase was attributable to increased commission expense of \$0.2 million that resulted from increased sales volumes.

General and Administrative Expenses. General and administrative expenses increased by 11.0%, or \$1.4 million, to \$14.2 million for 2003, from \$12.8 million for 2002. The increase was due primarily to increases in employee group health insurance of \$0.5 million and salary increases of \$0.3 million. Additional expense increases, which resulted from our continued growth, were \$0.3 million for depreciation, \$0.1 million for telecommunications and \$0.2 million for facilities rent. The increases were offset by a decrease of \$0.6 million in bad debt expense. We have also experienced increased expenses of \$0.3 million in professional fees, investor relations and directors' fees.

As a result of the foregoing factors, income before taxes increased by 2.1%, or \$0.3 million, to \$12.9 million for 2003, from \$12.6 million for 2002. This growth rate in income before taxes is less than the growth rate we achieved from 2001 to 2002, primarily because of the slower growth in system sales revenues described above.

Liquidity and Capital Resources

As of February 28, 2005, we had \$15.9 million in cash and cash equivalents. This cash reserve plus cash generated from our normal operating activities should be adequate to fund our business for the foreseeable future. Our principal source of liquidity has been cash provided by operating activities. Cash provided by operating activities has been used primarily to fund the growth in our business and, prior to our IPO, to pay S corporation distributions to our stockholders. We paid cash distributions to our pre-IPO stockholders in the aggregate amounts of \$0.3 million and \$16.9 million in 2003 and 2002, respectively. Because of our strong cash position, our board of directors decided to begin paying a quarterly dividend in 2003. We declared and paid dividends in the aggregate amount of \$5.0 million and \$2.7 million in 2004 and 2003, respectively. We believe that paying dividends is an effective way of providing an investment return to our stockholders and a beneficial use of our cash.

Net cash provided by operating activities totaled \$11.1 million, \$8.0 million and \$7.0 million for 2004, 2003 and 2002, respectively. In 2004, we experienced significant improvement in our cash collections, which produced a meaningful increase in our cash from operating activities. We also converted to a bi-weekly pay cycle from a semi-monthly payroll cycle in 2004, which resulted in an increase in other liabilities of approximately \$1.0 million due to a payroll accrual at year end. Upon the completion of our IPO in 2002, we converted from an S corporation to a C corporation for tax purposes. As a result, some of our cash provided by our operating activities is now required to pay taxes on our income.

Net cash used in investing activities totaled \$1.7 million, \$2.0 million and \$1.9 million for 2004, 2003 and 2002, respectively. In each of those years, we used cash for the purchase of property and equipment.

Net cash used in financing activities totaled \$5.0 million, \$2.9 million and \$0.7 million for 2004, 2003 and 2002, respectively. During 2004, we declared and paid dividends in the aggregate amount of \$5.0 million. During 2003, we declared and paid dividends in the aggregate amount of \$2.7 million. We also made a final cash distribution to our pre-IPO stockholders in the amount of \$0.3 million for previously taxed S corporation income in 2003. During 2002, we received \$16.9 million as net proceeds from our IPO. Prior to the IPO, we made cash distributions to our stockholders in the amount of \$2.6 million. From the IPO proceeds, we made additional cash distributions to our pre-IPO stockholders in the amount of \$14.3 million for previously taxed S corporation income. We also retired outstanding long-term debt in the amount of \$0.7 million.

Our days sales outstanding for the years 2004, 2003 and 2002 were 45, 50 and 57, respectively.

We currently do not have a bank line of credit or other credit facility in place. Because we have no debt, we will not be subject to contractual restrictions or other influences on our operations, such as payment demands and restrictions on the use of operating funds that are typically associated with debt. If we borrow money in the future, we will likely be subject to operating and financial covenants that could limit our ability to operate as profitably as we have in the past. Defaults under applicable loan agreements could result in the demand by lenders for immediate payment of substantial funds and substantial restrictions on expenditures, among other things.

Related Party Transactions

We lease the majority of our corporate headquarters campus from CP Investments, Inc., an Alabama corporation, the stockholders of which are John Morrissey, John Heyer, Bob O'Donnell, Elissa Stillings, Kevin P. Wilkins, Tabitha M. Wilkins Olzinski, Ellen M. Harvey, Michael K. Muscat, Jr. and Susan M. Slaton. All of these individuals are either stockholders of CPSI, or, in the case of Ms. Stillings, the spouse of a stockholder. In 2004, we paid total lease payments in the amount of \$1,344,492 to CP Investments, Inc. Under these lease agreements, we make annual lease payments in the amount of \$1,350,888, subject to adjustment as set forth in the agreements. The annual rent payable under these leases has been determined by an independent, third-party appraisal firm. The parties may agree, from time to time, to make adjustments in the annual rent payable under these leases based on subsequent third-party appraisals.

We lease the remainder of our headquarters facilities, which is comprised of one building that houses our dedicated research and development staff, from DJK, LLC, a limited liability company owned by Dennis Wilkins. In 2004, we paid total lease payments in the amount of \$40,581 to DJK, LLC. The annual rent payable under this lease has been determined by an independent, third-party appraisal firm.

Contractual Obligations

Our related party real estate leases are our only material contractual obligations requiring payments in the future. Our payments under these leases subsequent to December 31, 2004 will be as follows:

	Total	Payment due by period			
		Less Than 1 Year	1 – 3 Years	3 – 5 Years	More Than 5 Years
Contractual Obligations					
Operating Lease Obligations	\$10,273,074	\$ 1,391,664	\$ 2,783,328	\$ 2,783,328	\$ 3,314,754

Off-Balance Sheet Arrangements

We are not currently a party to any material "off-balance sheet arrangement" as defined in Item 303 of Regulation S-K.

Critical Accounting Policies

General. Our discussion and analysis of our financial condition and results of operations are based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. We are required to make some estimates and judgments that affect the preparation of these financial statements. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, but actual results may differ from these estimates under different assumptions or conditions.

Revenue Recognition. We recognize revenue in accordance with SEC Staff Accounting Bulletin No. 101 (SAB 101), Revenue Recognition in Financial Statements, as amended by SAB 104, Revenue Recognition, and the American Institute of Certified Public Accountants Statement of Position (SOP) 97-2, Software Revenue Recognition. SAB 104 and SOP 97-2 require that four basic criteria must be met before revenues can be recognized: (1) persuasive evidence that an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the fee is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) are based on our judgment regarding the fixed nature of the fee charged for services rendered and products delivered and the collectibility of those fees. Should changes in conditions cause us to determine these criteria are not met for certain future transactions, revenues recognized for any reporting period could be adversely affected.

Backlog

Backlog consists of revenues we reasonably expect to recognize over the next twelve months under existing contracts. The revenues to be recognized may relate to a combination of one-time fees for system sales, and recurring fees for support, outsourcing, ASP and ISP services. As of December 31, 2004, we had a twelve-month backlog of approximately \$20.0 million in connection with non-recurring system purchases and approximately \$50.8 million in connection with recurring payments under support, outsourcing, ASP and ISP contracts.

Quantitative and Qualitative Disclosures about Market and Interest Rate Risk

We reduce the sensitivity of our results of operations to market risks related to changes in interest rates by maintaining an investment portfolio comprised solely of highly rated, short-term investments. We do not hold or issue derivative, derivative commodity instruments or other financial instruments for trading purposes. We are not exposed to currency exchange fluctuations, as we do not sell our products internationally, and we currently have no exposure to equity price risks.

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment, which is a revision of SFAS No. 123 Accounting for Stock-Based Compensation. SFAS No. 123(R) is effective for public companies for interim or annual periods beginning after June 15, 2005, supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends SFAS No. 95, Statement of Cash Flows. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. The new standard will be effective, for us, beginning July 1, 2005. The Company is in the process of evaluating the impact of this standard on the financial statements.

RISK FACTORS

Market factors may cause a decline in spending for information technology and services by our current and prospective customers which may result in less demand for our products, lower prices and, consequently, lower revenues and a lower revenue growth rate.

The purchase of our information system involves a significant financial commitment by our customers. At the same time, the healthcare industry faces significant financial pressures that could adversely affect overall spending on healthcare information technology and services. For example, the Balanced Budget Act of 1997 has significantly reduced Medicare reimbursements to hospitals, leaving them less money to invest in infrastructure. Moreover, a general economic decline could cause hospitals to reduce or eliminate information technology related spending. To the extent spending for healthcare information technology and services declines or increases slower than we anticipate, demand for our products and services, as well as the prices we charge, could be adversely affected. Accordingly, we cannot assure you that we will be able to increase or maintain our revenues or our growth rate.

There are a limited number of hospitals in our target market. Continued consolidation in the healthcare industry could result in the loss of existing customers, a reduction in our potential customer base and downward pressure on our products' prices.

There are a finite number of small and midsize hospitals with 300 or fewer acute care beds. Saturation of this market with our products or our competitors' products could eventually limit our revenues and growth. Furthermore, many healthcare providers have consolidated to create larger healthcare delivery enterprises with greater market power. If this consolidation continues, we could lose existing customers and could experience a decrease in the number of potential purchasers of our products and services. The loss of existing and potential customers due to industry consolidation could cause our revenue growth rate to decline. In addition, larger, consolidated enterprises could have greater bargaining power, which may lead to downward pressure on the prices for our products and services.

We may experience fluctuations in quarterly financial performance that cause us to fail to meet revenues or earnings expectations. Failure to meet these expectations could adversely impact our stock price.

There is no assurance that consistent quarterly growth in our business will continue. Our quarterly revenues may fluctuate and may be difficult to forecast for a variety of reasons. For example, prospective customers often take significant time evaluating our system and related services before making a purchase decision. Moreover, a prospective customer who has placed an order for our system could decide to cancel that order or postpone installation of the ordered system. If a prospective customer delays or cancels a scheduled system installation during any quarter, we may not be able to schedule a substitute system installation during that quarter. The amount of revenues that would have been generated from that installation will be postponed or lost. The possibility of delays or cancellations of scheduled system installations could cause our quarterly revenues to fluctuate.

The following factors may also affect demand for our products and services and cause our quarterly revenues to fluctuate:

- changes in customer budgets and purchasing priorities;
- market acceptance of new products, product enhancements and services from us and our competitors;
- product and price competition; and
- delay of revenue recognition to future quarters due to an increase in the sale of our remote access ASP services.

Variations in our quarterly revenues may adversely affect our operating results. In each fiscal quarter, our expense levels, operating costs and hiring plans are based on projections of future revenues and are relatively fixed. If our actual revenues fall below expectations, our earnings will also likely fail to meet expectations. If we fail to meet the revenue or earnings expectations of securities analysts and investors, then the price of our common stock will likely decrease.

Competition with companies that have greater financial, technical and marketing resources than we have could result in loss of customers and/or a lowering of prices for our products, causing a decrease in our revenues and/or market share.

Our principal competitors are Meditech and HMS. Meditech and HMS compete with us directly in our target market of small and midsize hospitals. These companies offer products and services that are comparable to our system and are designed to address the needs of community hospitals.

Our secondary competitors include McKesson Corporation, Quadramed Corp., Cerner Corporation, and Siemens Corporation. These companies are significantly larger than we are, and they typically sell their products and services to larger hospitals outside of our target market. However, they sometimes compete directly with us. We also face competition from providers of practice management systems, general decision support and database systems and other segment-specific applications, as well as from healthcare technology consultants. Any of these companies as well as other technology or healthcare companies could decide at any time to specifically target hospitals within our target market.

A number of existing and potential competitors are more established than we are and have greater name recognition and financial, technical and marketing resources. Products of our competitors may have better performance, lower prices and broader market acceptance than our products. We expect increased competition that could cause us to lose customers, lower our prices to remain competitive and experience lower revenues, revenue growth and profit margins.

Our failure to develop new products or enhance current products in response to market demands could adversely impact our competitive position and require substantial capital resources to correct.

The needs of hospitals in our target market are subject to rapid change due to government regulation, trends in clinical care practices and technological advancements. As a result of these changes, our products may quickly become obsolete or less competitive. New product introductions and enhancements by our competitors that more effectively or timely respond to changing industry needs may weaken our competitive position.

We continually redesign and enhance our products to incorporate new technologies and adapt our products to ever-changing hardware and software platforms. Often we face difficult choices regarding which new technologies to adopt. If we fail to anticipate or respond adequately to technological advancements, or experience significant delays in product development or introduction, our competitive position could be negatively affected. Moreover, our failure to offer products acceptable to our target market could require us to make significant capital investments and incur higher operating costs to redesign our products, which could negatively affect our financial condition and operating results.

Potential regulation of our products as medical devices by the U.S. Food and Drug Administration could increase our costs, delay the introduction of new products and slow our revenue growth.

The U.S. Food and Drug Administration, or the "FDA," is likely to become more active in regulating the use of computer software for clinical purposes. The FDA has increasingly regulated computer products and computer-assisted products as medical devices under the federal Food, Drug and

Cosmetic Act. If the FDA regulates any of our products as medical devices, we would likely be required to, among other things:

- seek FDA clearance by demonstrating that our product is substantially equivalent to a device already legally marketed, or obtain FDA approval by establishing the safety and effectiveness of our product;
- comply with rigorous regulations governing pre-clinical and clinical testing, manufacture, distribution, labeling and promotion of medical devices; and
- comply with the Food, Drug and Cosmetic Act's general controls, including establishment registration, device listing, compliance with good manufacturing practices and reporting of specified device malfunctions and other adverse device events.

We anticipate that some of our products currently in development will be subject to FDA regulation. If any of our products fail to comply with FDA requirements, we could face FDA refusal to grant pre-market clearance or approval of products; withdrawal of existing clearances and approvals; fines, injunctions or civil penalties; recalls or product corrections; production suspensions; and criminal prosecution. FDA regulation of our products could increase our operating costs, delay or prevent the marketing of new or existing products and adversely affect our revenue growth.

Governmental regulations relating to patient confidentiality and other matters could increase our costs.

State and federal laws regulate the confidentiality of patient records and the circumstances under which those records may be released. These regulations may require the users of such information to implement security measures. Regulations governing electronic health data transmissions are also evolving rapidly, and they are often unclear and difficult to apply.

The Health Insurance Portability and Accountability Act of 1996, or "HIPAA," requires, among other things, the Secretary of Health and Human Services, or "HHS," to adopt national standards to ensure the integrity and confidentiality of health information. HHS's health data privacy regulations restrict the use and disclosure of personally identifiable health information without the prior informed consent of the patient. In addition, HHS has also issued final regulations establishing national standards for some healthcare-related electronic transactions and uniform code sets to be used in those transactions. While these new standards are in active use by virtually all intermediaries, the regulation leaves some portions of the code at the discretion of the individual intermediaries. This leaves the potential for future changes dictated by not only the federal government but also by the individual intermediaries. In February 2003, HHS issued final rules with respect to information security that would require healthcare providers to implement organizational practices to protect the security of electronically maintained or transmitted health-related information, such as the use of electronic signatures and single sign-on access to information. Customers must be in compliance with these new regulations by April 2005. HHS has also provided a final rule for employer identifiers; however no other rules, proposed or final, have yet been issued with respect to unique health identifiers for providers or patients. We cannot predict the potential impact of proposed rules and rules that have not yet been proposed. In addition to HIPAA, other federal and/or state privacy legislation may be enacted at any time.

In our support agreements with our customers, we agree to update our software applications to comply with applicable federal and state laws. While we believe we have developed products that will comply with current HIPAA and other regulatory requirements, new laws, regulations and interpretations could force us to further redesign our products. Any such product redesign could consume significant

capital, research and development and other resources, which could significantly increase our operating costs.

Our products assist clinical decision-making and related care by capturing, maintaining and reporting relevant patient data. If our products fail to provide accurate and timely information, our customers could assert claims against us that could result in substantial cost to us, harm our reputation in the industry and cause demand for our products to decline.

We provide products that assist clinical decision-making and related care by capturing, maintaining and reporting relevant patient data. Our products could fail or produce inaccurate results due to a variety of reasons, including mechanical error, product flaws, faulty installation and/or human error during the initial data conversion. If our products fail to provide accurate and timely information, customers and/or patients could sue us to hold us responsible for losses they incur from these errors. These lawsuits, regardless of merit or outcome, could result in substantial cost to us, divert management's attention from operations and decrease market acceptance of our products. We attempt to limit by contract our liability for damages arising from negligence, errors or mistakes. Despite this precaution, such contract provisions may not be enforceable or may not otherwise protect us from liability for damages. We maintain general liability insurance coverage, including coverage for errors or omissions. However, this coverage may not be sufficient to cover one or more large claims against us or otherwise continue to be available on terms acceptable to us. In addition, the insurer could disclaim coverage as to any future claim.

Breaches of security in our system could result in customer claims against us and harm to our reputation causing us to incur expenses and/or lose customers.

We have included security features in our systems that are intended to protect the privacy and integrity of patient data. Despite the existence of these security features, our system may experience break-ins and similar disruptive problems that could jeopardize the security of information stored in and transmitted through the computer networks of our customers. Because of the sensitivity of medical information, customers could sue us for breaches of security involving our system. Also, actual or perceived security breaches in our system could harm the market perception of our products which could cause us to lose existing and prospective customers.

New products that we introduce or enhancements to our existing products may contain undetected errors or problems that could affect customer satisfaction and cause a decrease in revenues.

Highly complex software products such as ours sometimes contain undetected errors or failures when first introduced or when updates and new versions are released. Tests of our products may not detect bugs or errors because it is difficult to simulate our customers' wide variety of computing environments. Despite extensive testing, from time to time we have discovered defects or errors in our products. Defects or errors discovered in our products could cause delays in product introductions and shipments, result in increased costs and diversion of development resources, require design modifications, decrease market acceptance or customer satisfaction with our products, cause a loss of revenue, result in legal actions by our customers and cause increased insurance costs.

Our facilities are located in an area vulnerable to hurricanes and tropical storms, and the occurrence of a severe hurricane, similar storm or other natural disaster could cause damage to our facilities and equipment, which could require us to cease or limit our operations.

All of our facilities and virtually all of our employees are situated on one campus in Mobile, Alabama, which is located on the coast of the Gulf of Mexico. Our facilities are vulnerable to significant damage or destruction from hurricanes and tropical storms. We are also vulnerable to damage from other types of disasters, including tornadoes, fires, floods and similar events. If any disaster were to occur, our

ability to conduct business at our facilities could be seriously impaired or completely destroyed. This would have adverse consequences for our customers who depend on us for system support or outsourcing services. Also, the servers of customers who use our remote access services could be damaged or destroyed in any such disaster. This would have potentially devastating consequences to those customers. Although we have an emergency recovery plan, there can be no assurance that this plan will effectively prevent the interruption of our business due to a natural disaster. Furthermore, the insurance we maintain may not be adequate to cover our losses resulting from any natural disaster or other business interruption.

Interruptions in our power supply and/or telecommunications capabilities could disrupt our operations, cause us to lose revenues and/or increase our expenses.

We currently have backup generators to be used as alternative sources of power in the event of a loss of power to our facilities. If these generators were to fail during any power outage, we would be temporarily unable to continue operations at our facilities. This would have adverse consequences for our customers who depend on us for system support and outsourcing services. Any such interruption in operations at our facilities could damage our reputation, harm our ability to retain existing customers and obtain new customers, and could result in lost revenue and increased insurance and other operating costs.

We also have customers for whom we store and maintain computer servers containing critical patient and administrative data. Those customers access this data remotely through telecommunications lines. If our power generators fail during any power outage or if our telecommunications lines are severed or impaired for any reason, those customers would be unable to access their mission critical data causing an interruption in their operations. In such event our remote access customers and/or their patients could seek to hold us responsible for any losses. We would also potentially lose those customers, and our reputation could be harmed.

If we are unable to attract and retain qualified customer service and support personnel our business and operating results will suffer.

Our customer service and support is a key component of our business. Most of our hospital customers have small information technology staffs, and they depend on us to service and support their systems. Future difficulty in attracting, training and retaining capable customer service and support personnel could cause a decrease in the overall quality of our customer service and support. That decrease would have a negative effect on customer satisfaction which could cause us to lose existing customers and could have an adverse effect on our new customer sales. The loss of customers due to inadequate customer service and support would negatively impact our ability to continue to grow our business.

We do not have employment or non-competition agreements with our key personnel, and their departure could harm our future success.

Our future success depends to a significant extent on the leadership and performance of our chief executive officer, chief operating officer and other executive officers. We do not have employment or non-competition agreements with any of our executive officers. Therefore, they may terminate their employment with us at any time and may compete against us. The loss of the services of any of our executive officers could have a material adverse effect on our business, financial condition and results of operations.

We have limited protection of our intellectual property and, if we fail to adequately protect our intellectual property, we may not be able to compete effectively.

We consider some aspects of our internal operations, products and documentation to be proprietary. To some extent we have relied on a combination of confidentiality provisions in our customer agreements, copyright, trademark and trade secret laws and other measures to protect our intellectual

property. To date, however, we have not filed any patent applications to protect our proprietary software products. In addition, existing copyright laws afford only limited protection. Although we attempt to control access to our intellectual property, unauthorized persons may attempt to copy or otherwise use our intellectual property. Monitoring unauthorized use of our intellectual property is difficult, and the steps we have taken may not prevent unauthorized use. If our competitors gain access to our intellectual property, our competitive position in the industry could be damaged. An inability to compete effectively could cause us to lose existing and potential customers and experience lower revenues, revenue growth and profit margins.

In the event our products infringe on the intellectual property rights of third-parties, our business may suffer if we are sued for infringement or if we cannot obtain licenses to these rights on commercially acceptable terms.

Others may sue us alleging infringement of their intellectual property rights. Many participants in the technology industry have an increasing number of patents and patent applications and have frequently demonstrated a readiness to take legal action based on allegations of patent and other intellectual property infringement. Further, as the number and functionality of our products increase, we believe we may become increasingly subject to the risk of infringement claims. If infringement claims are brought against us, these assertions could distract management. We may have to spend a significant amount of money and time to defend or settle those claims. If we were found to infringe on the intellectual property rights of others, we could be forced to pay significant license fees or damages for infringement. If we were unable to obtain licenses to these rights on commercially acceptable terms, we would be required to discontinue the sale of our products that contain the infringing technology. Our customers would also be required to discontinue the use of those products. We are unable to insure against this risk on an economically feasible basis. Even if we were to prevail in an infringement lawsuit, the accompanying publicity could adversely impact the demand for our system. Under some circumstances, we agree to indemnify our customers for some types of infringement claims that may arise from the use of our products.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this item is contained in Item 7 herein under the heading "Quantitative and Qualitative Disclosures about Market and Interest Rate Risk."

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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All other schedules to the financial statements required by Article 9 of Regulation S-X are inapplicable and therefore have been omitted.

REPORT OF MANAGEMENT

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. CPSI's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. CPSI's internal control over financial reporting includes those policies and procedures that:

- (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of CPSI;

- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of CPSI; and

- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of CPSI's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of CPSI's internal control over financial reporting as of December 31, 2004. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on our assessment and those criteria, management believes that CPSI maintained effective internal control over financial reporting as of December 31, 2004.

CPSI's independent auditors, Grant Thornton, LLP, have issued an attestation report on management's assessment of CPSI's internal control over financial reporting. That report appears on page 40 of this Form 10-K.

**REPORT OF GRANT THORNTON, LLP, INDEPENDENT REGISTERED PUBLIC
ACCOUNTING FIRM, ON FINANCIAL STATEMENTS**

The Board of Directors
Computer Programs and Systems, Inc.

We have audited the accompanying balance sheet of Computer Programs and Systems, Inc. as of December 31, 2004, and the related statements of income, stockholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Computer Programs and Systems, Inc. as of December 31, 2004, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Schedule II for the year ended December 31, 2004, is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Computer Programs and Systems, Inc.'s internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") and our report dated March 4, 2005 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ Grant Thornton LLP

Atlanta, Georgia
March 4, 2005

**REPORT OF GRANT THORNTON LLP, INDEPENDENT REGISTERED PUBLIC
ACCOUNTING FIRM, ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Board of Directors
Computer Programs and Systems, Inc.

We have audited management's assessment included in Management's Report on Internal Controls Over Financial Reporting included in Computer Programs and Systems, Inc. Form 10K for 2004, that Computer Programs and Systems, Inc. maintained effective internal control over financial reporting as of December 31, 2004 based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Computer Programs and Systems, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Computer Programs and Systems, Inc. maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by the COSO. Also in our opinion, Computer Programs and Systems, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control—Integrated Framework issued by the COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheet of Computer Programs and Systems, Inc. as of December 31, 2004 and the related statements of income, stockholders' equity, and cash flows for the year then ended and our report dated March 4, 2005 expressed an unqualified opinion on those financial statements.

/s/ Grant Thornton LLP

Atlanta, Georgia
March 4, 2005

**REPORT OF ERNST & YOUNG LLP, INDEPENDENT REGISTERED
PUBLIC ACCOUNTING FIRM**

The Board of Directors
Computer Programs and Systems, Inc.

We have audited the accompanying balance sheet of Computer Programs and Systems, Inc. as of December 31, 2003, and the related statements of income, stockholders' equity and cash flows for the years ended December 31, 2003 and 2002. Our audits also included the 2003 and 2002 information included in the financial statement schedule listed in the index at Item 8. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes *consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances*, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Computer Programs and Systems, Inc. at December 31, 2003, and the results of its operations and its cash flows for the years ended December 31, 2003 and 2002, in conformity with U. S. generally accepted accounting principles. Also, in our opinion, the 2003 and 2002 information included in the related financial statement schedule, when considered in relation to the financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP

February 3, 2004
Birmingham, Alabama

COMPUTER PROGRAMS AND SYSTEMS, INC.

Balance Sheets

	December 31, 2004	December 31, 2003
Assets		
Current assets:		
Cash and cash equivalents	\$ 13,785,377	\$ 9,472,743
Accounts receivable, net of allowance for doubtful accounts of \$1,636,000 and \$904,000, respectively	11,764,465	11,916,414
Financing receivables, current portion	974,160	1,112,773
Inventories	1,475,166	1,102,061
Deferred tax assets	1,397,016	1,039,439
Prepaid income taxes	171,574	120,025
Prepaid expenses	437,716	364,384
Total current assets	30,005,474	25,127,839
Property and equipment		
Land	936,026	936,026
Maintenance equipment	3,298,140	3,172,303
Computer equipment	4,854,331	4,320,011
Office furniture and equipment	1,481,314	1,391,110
Automobiles	89,934	89,934
	10,659,745	9,909,384
Less accumulated depreciation	(5,204,730)	(4,561,080)
Net property and equipment	5,455,015	5,348,304
Financing receivables	617,657	793,870
Total assets	<u>\$ 36,078,146</u>	<u>\$ 31,270,013</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 969,454	\$ 1,126,334
Deferred revenue	2,602,235	1,633,887
Accrued vacation	1,630,382	1,561,577
Other accrued liabilities	2,323,433	1,129,976
Total current liabilities	7,525,504	5,451,774
Deferred tax liabilities	718,753	66,266
Stockholders' equity:		
Common stock, \$0.001 par value; 30,000,000 shares authorized; 10,489,849 shares issued and outstanding	10,490	10,490
Additional paid-in capital	17,292,079	17,289,910
Deferred compensation	(123,345)	(174,385)
Retained earnings	10,654,665	8,625,958
Total stockholders' equity	27,833,889	25,751,973
Total liabilities and stockholders' equity	<u>\$ 36,078,146</u>	<u>\$ 31,270,013</u>

See accompanying notes.

COMPUTER PROGRAMS AND SYSTEMS, INC.

Statements of Income

	Year ended December 31,		
	2004	2003	2002
Sales revenues:			
System sales	\$ 35,252,410	\$ 39,707,684	\$ 38,309,227
Support and maintenance	38,010,122	34,567,017	30,246,030
Outsourcing	9,401,468	7,028,159	5,188,963
Total sales revenues	82,664,000	81,302,860	73,744,220
Costs of sales:			
System sales	27,064,273	28,045,002	25,837,901
Support and maintenance	16,915,781	16,100,525	13,905,072
Outsourcing	5,595,774	4,258,778	3,182,430
Total costs of sales	49,575,828	48,404,305	42,925,403
Gross profit	33,088,172	32,898,555	30,818,817
Operating expenses:			
Sales and marketing	6,054,654	6,125,437	5,933,472
General and administrative	15,830,863	14,227,439	12,816,785
Total operating expenses	21,885,517	20,352,876	18,750,257
Operating income	11,202,655	12,545,679	12,068,560
Other income (expense):			
Interest income	257,462	216,001	214,044
Miscellaneous income	243,191	121,797	361,682
Interest expense	-	-	(23,677)
Total other income	500,653	337,798	552,049
Income before taxes	11,703,308	12,883,477	12,620,609
Income taxes	4,639,473	5,017,647	1,970,816
Net income	\$ 7,063,835	\$ 7,865,830	\$ 10,649,793
Net income per share - basic	\$ 0.67	\$ 0.75	\$ 1.06
Net income per share - diluted	\$ 0.67	\$ 0.75	\$ 1.06
Weighted average shares outstanding			
Basic	10,489,849	10,488,406	10,024,438
Diluted	10,535,555	10,536,929	10,061,765
Unaudited pro forma income data:			
Historical income before provision for income taxes			\$ 12,620,609
Pro forma income taxes			4,576,654
Pro forma net income			\$ 8,043,955
Pro forma net income per share - basic			\$ 0.80
Pro forma net income per share - diluted			\$ 0.80

See accompanying notes.

COMPUTER PROGRAMS AND SYSTEMS, INC.

Statements of Stockholders' Equity

	Common Shares	Common Stock	Additional Paid-In Capital	Deferred Compensation	Retained Earnings	Total Stockholders' Equity
Balance at December 31, 2001	9,288,000	\$ 9,288	\$ 109,811	\$ -	\$ 9,917,283	\$10,036,382
Net income	-	-	-	-	10,649,793	10,649,793
Issuance of common stock	1,200,000	1,200	16,894,396	-	-	16,895,596
Deferred compensation	-	-	255,196	(255,196)	-	-
Amortization of deferred compensation	-	-	-	29,773	-	29,773
Distribution of S corporation shareholders	-	-	-	-	(17,132,508)	(17,132,508)
Balance at December 31, 2002	10,488,000	10,488	17,259,403	(225,423)	3,434,568	20,479,036
Net income	-	-	-	-	7,865,830	7,865,830
Issuance of common stock	1,849	2	30,507	-	-	30,509
Dividends	-	-	-	-	(2,674,440)	(2,674,440)
Amortization of deferred compensation	-	-	-	51,038	-	51,038
Balance at December 31, 2003	10,489,849	10,490	17,289,910	(174,385)	8,625,958	25,751,973
Net income	-	-	-	-	7,063,835	7,063,835
Issuance of common stock	-	-	2,169	-	-	2,169
Dividends	-	-	-	-	(5,035,128)	(5,035,128)
Amortization of deferred compensation	-	-	-	51,040	-	51,040
Balance at December 31, 2004	<u>10,489,849</u>	<u>\$ 10,490</u>	<u>\$17,292,079</u>	<u>\$ (123,345)</u>	<u>\$10,654,665</u>	<u>\$27,833,889</u>

See accompanying notes.

COMPUTER PROGRAMS AND SYSTEMS, INC.

Statements of Cash Flows

	Year ended December 31,		
	2004	2003	2002
Operating Activities			
Net income	\$ 7,063,835	\$ 7,865,830	\$ 10,649,793
Adjustments to net income:			
Provision for bad debt	732,321	256,790	818,327
Deferred taxes	294,910	33,297	(1,006,470)
Deferred compensation	51,040	51,038	29,773
Depreciation	1,619,792	1,461,039	1,128,454
Changes in operating assets and liabilities:			
Accounts receivable	(580,372)	425,307	(5,309,371)
Financing receivables	314,826	275,007	(413,430)
Inventories	(373,105)	513,251	(488,959)
Prepaid expenses	(73,332)	(36,851)	(131,257)
Accounts payable	(156,880)	(967,478)	1,060,463
Deferred revenue	968,348	(713,929)	746,686
Other accrued liabilities	1,262,262	(852,988)	(286,187)
Income taxes payable	(49,380)	(313,571)	193,546
Net cash provided by operating activities	11,074,265	7,996,742	6,991,368
Investing Activities			
Purchases of property and equipment	(1,726,503)	(1,982,520)	(1,920,750)
Net cash used in investing activities	(1,726,503)	(1,982,520)	(1,920,750)
Financing Activities			
Proceeds from issuance of common stock, net of expenses	-	30,509	16,895,596
Principal payments on note payable	-	-	(749,897)
Dividends paid	(5,035,128)	(2,674,440)	-
Distributions to S corporation shareholders	-	(250,000)	(16,882,508)
Net cash used in financing activities	(5,035,128)	(2,893,931)	(736,809)
Increase in cash and cash equivalents	4,312,634	3,120,291	4,333,809
Cash and cash equivalents at beginning of year	9,472,743	6,352,452	2,018,643
Cash and cash equivalents at end of year	<u>\$ 13,785,377</u>	<u>\$ 9,472,743</u>	<u>\$ 6,352,452</u>
Supplemental disclosure of cash flow information			
Cash paid for interest	\$ -	\$ -	\$ 23,677
Cash paid for income taxes	\$ 4,396,112	\$ 5,331,218	\$ 2,783,740

See accompanying notes.

COMPUTER PROGRAMS AND SYSTEMS, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2004

1. BASIS OF PRESENTATION

Computer Programs and Systems, Inc. (CPSI or the Company) is a healthcare information technology solutions provider which was formed and commenced operations in 1979. The Company provides, on an integrated basis, enterprise-wide clinical management, access management, patient financial management, health information management, strategic decision support, resource planning management and enterprise application integration solutions to healthcare organizations throughout the United States. Additionally, CPSI provides other information technology solutions including outsourcing, remote hosting, networking technologies and other related services.

2. PUBLIC OFFERING OF COMMON STOCK AND RECAPITALIZATION

On May 24, 2002, the Company successfully completed an initial public offering of 3.0 million shares of common stock at a price of \$16.50 per share. Of the shares offered, 1.2 million shares were sold by the Company and 1.8 million shares were sold by selling stockholders. In addition, the underwriters for the Company exercised their over-allotment option by purchasing an additional 450,000 shares at \$16.50 per share from selling stockholders. Of the net proceeds to the Company of approximately \$16.9 million, approximately \$14.3 million was used to fund a partial distribution to pre-IPO stockholders of previously taxed S corporation income, and the balance was used to repay outstanding debt and for general corporate purposes.

On May 1, 2002, the Company declared a 430-for-1 stock split, and on May 6, 2002, the Company amended its Articles of Incorporation to increase the Company's total authorized shares to 10,000,000 and to change the par value to \$0.001 per share. All share and per share amounts for all periods presented in the accompanying financial statements have been restated to reflect the split.

Effective immediately prior to the completion of the offering, the Company reincorporated in Delaware. As a Delaware corporation, the Company now has 30,000,000 shares of authorized common stock with a par value per share of \$0.001.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

Cash and cash equivalents consists of highly-liquid financial instruments, primarily cash and money market funds, purchased with an original maturity of three months or less.

Inventories

Inventories are stated at cost using the average cost method. The Company's inventories are composed of computer equipment, forms and supplies.

Property and Equipment

Property and equipment is recorded at cost, less accumulated depreciation. Additions and improvements to property and equipment that materially increase productive capacity or extend the life of an asset are capitalized. Maintenance, repairs and minor renewals are expensed as incurred. Upon retirement or other disposition of such assets, the related costs and accumulated depreciation are removed from the respective accounts and any resulting gain or loss is included in the results of operations.

Depreciation expense is computed using the straight-line method over the asset's useful life, generally 5 years. The Company reviews for the possible impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Deferred Revenue

Deferred revenue represents amounts received from customers under licensing agreements and implementation fees for which the revenue earnings process has not been completed.

Revenue Recognition

Systems sales revenues are derived from the sale of information systems (including software, conversion and installation services, hardware, peripherals, forms and office supplies) to new customers and from the sale of new or additional products to existing customers. The Company recognizes revenue from systems sales on a completed contract basis in accordance with American Institute of Certified Public Accountants Statement of Position (SOP) 97-2, *Software Revenue Recognition*, and SOP 81-1, *Accounting for Performance of Construction Type and Certain Production-Type Contracts*. A contract is regarded as substantially complete when all hardware and software is installed and the system is operating as intended. Losses are recorded for the entire estimated loss on the contract in the period that it becomes evident that current estimates of total contract revenue and contract costs indicate a loss.

The Company does not record revenue upon execution of a sales contract. Each customer initially remits a non-refundable 10% deposit that is recorded as deferred revenue. The customer then pays 40% of the purchase price when the Company commences training on-site at the customer's facility. When the system becomes operational, the Company bills the remaining 50% of the system purchase price and recognizes revenue for the total amount of the purchase price. Costs relating to system sales revenues are deferred and recognized at the time the related revenues are recognized; however, at December 31, 2004 and 2003, no system sales-related costs were deferred as all contracts were deemed to be substantially complete, or such amounts were not considered to be material. Revenues derived from installation of additional software applications are generally recognized upon installation. Revenues from the sale of hardware are recognized upon the shipment of the product to the customer.

The Company also derives revenues from the provision of system support services, including software application support, hardware maintenance, continuing education and related services. Support services are provided pursuant to a General Support Agreement under which the Company provides comprehensive system support and related services in exchange for a monthly fee based on the services provided. These contracts range in duration from 1 to 7 years, with an average duration of 5 years, and renew automatically unless terminated by the customer. Revenues from support services are recognized in the month when these services are performed.

As part of system sales, the Company also provides services to some customers as an application service provider (ASP) for a monthly fee. In addition, the Company offers Internet services (ISP) to customers for a monthly fee. Revenues from ASP and ISP services are recognized in the month when these services are performed.

Outsourcing services are sold pursuant to one-year customer agreements, with automatic one-year renewals. Revenues from outsourcing services are recognized when services are performed.

Stock Based Compensation

During 2002, the Company adopted the 2002 Stock Option Plan, and in accordance with the disclosure provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company has elected to follow APB No. 25, *Accounting for Stock Issued to Employees* and related interpretations in accounting for employee stock options. Under APB No. 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense was reflected in net income for the year ended December 31, 2004, 2003 or 2002. Had the Company accounted for its stock-based compensation plan based on the fair value of awards at grant date, consistent with the methodology of SFAS No. 123, the Company's reported net income and income per share for the years ended December 31, 2004, 2003 and 2002 would have been impacted as indicated below. There were no employee stock options granted during the year ended December 31, 2004, 2003 or 2002. The effects of applying SFAS No. 123 on a pro forma basis for the years ended December 31, 2004, 2003 and 2002, are not likely to be representative of the effects on reported pro forma net income for future years as options vest over several years and it is anticipated that additional grants will be made in future years.

	December 31,		
	2004	2003	2002
Net income as reported	\$ 7,063,835	\$ 7,865,830	\$10,649,793
Add: Stock-based compensation expense, net of tax, included in reported net income	31,900	31,899	18,608
Deduct: Total stock-based employee compensation expense determined under the fair value method for all awards	<u>(310,861)</u>	<u>(224,067)</u>	<u>(136,044)</u>
Pro forma	\$ 6,784,874	\$ 7,673,662	\$10,532,357
Diluted income per share as reported	<u>\$ 0.67</u>	<u>\$ 0.75</u>	<u>\$ 1.06</u>
Pro forma diluted income per share	<u>\$ 0.64</u>	<u>\$ 0.73</u>	<u>\$ 1.05</u>

Research and Development Costs

Research and development costs are expensed as incurred. Research and development costs totaled approximately \$1,362,000, \$1,143,000 and \$1,104,000 for the years ended December 31, 2004, 2003 and 2002, respectively.

Software Development Costs

According to Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*, all costs incurred to establish the technological feasibility of a computer software product to be sold, leased or otherwise marketed are research and development costs and are charged to expense during the period when the costs are incurred. Costs incurred subsequent to establishing technological feasibility are capitalized. Capitalization of computer software costs ceases when the product is available for general release to customers. The Company has determined that costs to be capitalized based on SFAS No. 86 are not material. Capitalizable software development costs of approximately \$108,000, \$189,000 and \$104,000 were charged to expense during the years ended December 31, 2004, 2003 and 2002, respectively.

Advertising

Advertising costs are expensed as incurred. Advertising expense was approximately \$80,000, \$307,000 and \$373,000 for the years ended December 31, 2004, 2003 and 2002, respectively, and are recorded in general and administrative expenses in the accompanying statements of income.

Shipping and Handling Costs

Shipping and handling costs are expensed as incurred. Shipping and handling costs totaled approximately \$890,000, \$764,000 and \$664,000 for the years ended December 31, 2004, 2003 and 2002, respectively.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the financial statements and the reported revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Recently Issued Accounting Standards

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), *Share-Based Payment*, which is a revision of SFAS No. 123 *Accounting for Stock-Based Compensation*. SFAS No. 123(R) is effective for public companies for interim or annual periods beginning after June 15, 2005, supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. The new standard will be effective, upon us, beginning July 1, 2005. The Company is in the process of evaluating the impact of this standard on the financial statements.

Reclassifications

Certain amounts in the 2003 financial statements have been reclassified to conform to the 2004 classifications.

4. DETAILS ON BALANCE SHEET AMOUNTS

Other accrued liabilities are comprised of the following at December 31, 2004 and 2003:

	2004	2003
Accrued salaries and benefits	\$ 1,613,420	\$ 479,677
Accrued commissions	436,307	337,997
Accrued self-insurance claims	244,500	270,100
Other	29,206	42,202
	<u>\$ 2,323,433</u>	<u>\$ 1,129,976</u>

5. NET INCOME PER SHARE

Pro forma net income per share consists of the Company's historical net income as an S corporation, adjusted for additional income taxes that would have been recorded had the Company operated as a C corporation for the entire period presented. The Company presents both basic and diluted earnings per share (EPS) amounts. Basic EPS is calculated by dividing net income by the weighted average number of common shares outstanding during the period presented. Diluted EPS amounts are based upon the weighted average number of common and common equivalent shares outstanding during the period presented. The difference between basic and diluted EPS is solely attributable to stock options. The Company uses the treasury stock method to calculate the impact of outstanding stock options. For the years ended December 31, 2004, 2003, and 2002 these dilutive shares were 45,706, 48,523, and 37,327 respectively.

6. INCOME TAXES

The financial statements of the Company do not include a provision for income taxes through May 20, 2002 because the taxable income of the Company was included in the income tax returns of the shareholders under the S corporation election through that date. Upon completion of the IPO, the Company's S corporation status was terminated, and the Company became subject to federal and state income taxes. Upon revocation of the S corporation election, the Company recorded a \$934,000 credit to the deferred tax provision. Prior to its termination as an S corporation, the Company declared a distribution of earned, but undistributed, accumulated S corporation earnings through the date the Company became a C corporation. A partial distribution in the amount of \$12,750,000 was paid on May 28, 2002. An additional distribution of \$1,532,510 was made during the fourth quarter of 2002. During 2003, a final distribution of \$250,000, representing the remaining balance due, was paid to pre-IPO stockholders.

The Company provides for income taxes using the liability method in accordance with SFAS No. 109, *Accounting for Income Taxes*. Deferred income taxes arise from the temporary differences in the recognition of income and expenses for tax purposes. A valuation allowance is established when the Company believes that it is more likely than not that some portion of its deferred tax assets will not be realized.

Deferred tax assets and liabilities are comprised of the following at December 31, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Deferred tax assets:		
Accounts receivable	\$ 638,044	\$ 343,402
Accrued liabilities	<u>758,972</u>	<u>696,037</u>
Total deferred tax assets	<u>\$ 1,397,016</u>	<u>\$ 1,039,439</u>
Deferred tax liabilities:		
Deferred compensation	\$ 48,104	\$ 66,266
Depreciation	<u>670,649</u>	<u>-</u>
Total deferred tax liabilities	<u>\$ 718,753</u>	<u>\$ 66,266</u>

Significant components of the income tax provision (benefit) for the year ended December 31, 2004, 2003 and 2002 are as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Current provision:			
Federal	\$ 3,560,880	\$ 4,339,486	\$ 2,575,944
State	783,683	644,864	401,342
Deferred provision:			
Federal	262,036	29,793	(900,526)
State	<u>32,874</u>	<u>3,504</u>	<u>(105,944)</u>
Total income tax provision	<u>\$ 4,639,473</u>	<u>\$ 5,017,647</u>	<u>\$ 1,970,816</u>

The difference between income taxes at the U.S. federal statutory income tax rate of 35% and those reported in the statement of income for the years ended December 31, 2004, 2003 and 2002 are as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Income taxes at U. S. Federal statutory rate	\$ 4,096,158	\$ 4,509,217	\$ 4,417,213
State income tax, net of federal tax effect	646,722	427,923	259,869
Impact of graduated tax rates	(100,000)	(100,000)	(100,000)
S corporation	-	-	(1,657,622)
Change in tax status	-	-	(934,262)
Other	<u>(3,407)</u>	<u>180,507</u>	<u>(14,382)</u>
	<u>\$ 4,639,473</u>	<u>\$ 5,017,647</u>	<u>\$ 1,970,816</u>

7. DEFERRED COMPENSATION

On May 17, 2002, Kenny Muscat, one of the Company's directors and a principal stockholder sold 66,667 shares of common stock to J. Boyd Douglas, Jr., one of the Company's directors and its Chief Operating Officer (COO), for a price of \$13.20 per share. The share price was determined by an independent valuation of the fair market value of the shares. A promissory note was delivered for the entire purchase price. The promissory note bears interest at the applicable rate for federal income tax

purposes, and the entire principal balance is due five years after the date of the stock sale. As a part of the same transaction, Mr. Muscat also transferred to Mr. Douglas 19,333 shares of common stock for \$1.00. These shares are subject to a mandatory transfer obligation under which Mr. Douglas will be required to transfer the shares back to Mr. Muscat in the event Mr. Douglas' employment with the Company terminates for certain reasons prior to the fifth anniversary of the transaction date. The mandatory transfer obligation will lapse as to 20% of the shares on each anniversary of the transaction date over the five year restriction period.

As a result of this transaction, the Company recorded deferred compensation expense of \$255,196, representing the excess of the fair market value of the 19,333 shares transferred by Mr. Muscat to Mr. Douglas. The Company is amortizing the deferred compensation expense over 20 fiscal quarters, recognizing pre-tax compensation expense of \$12,760 per quarter.

8. STOCK OPTION PLAN

Under the 2002 Stock Option Plan, the Company has authorized the issuance of equity-based awards for up to 1,165,333 shares of common stock to provide additional incentive to employees and officers. Pursuant to the plan, the Company can grant either incentive or non-qualified stock options. Options to purchase common stock under the 2002 Stock Option Plan have been granted to Company employees with an exercise price equal to the fair market value of the underlying shares on the date of grant.

Stock options granted under the 2002 Stock Option Plan to executive officers of the Company become vested as to all of the shares covered by such grant on the fifth anniversary of the grant date and expire on the seventh anniversary of the grant date. Stock options granted under the 2002 Stock Option Plan to employees other than executive officers become vested as to 50% of the shares covered by the option grant on the third anniversary of the grant date and as to 100% of such shares on the fifth anniversary of the grant date. In addition, options become vested upon termination of employment resulting from death, disability or retirement. Such options expire on the seventh anniversary of the grant date.

Under the methodology of SFAS No. 123, the fair value of the Company's stock options was estimated at the date of grant using the Black-Scholes option pricing model. The multiple option approach was used, with assumptions for expected option life of 5 years and 44% expected volatility for the market price of the Company's stock in 2002. An estimated dividend yield of 3% was used. The risk-free rate of return was determined to be 2.79% in 2002. No options were granted in 2004 or 2003.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because subjectivity of assumptions can materially affect estimate of fair value, the Company believes the Black-Scholes model does not necessarily provide a reliable single measure of the fair value of its employee stock options.

The weighted average grant date fair value of options granted to employees under the 2002 Stock Option Plan during 2002 was \$5.30. During 2002, options were granted under the plan at exercise prices equal to the market value of the Company's stock on the date of grant.

A summary of stock option activity under the plan is as follows:

	2004		2003	
	Shares	Exercise Price	Shares	Exercise Price
Beginning of year	424,759	\$ 16.50	444,998	\$ 16.50
Granted	-	-	-	-
Exercised	-	-	(1,849)	16.50
Forfeited	(24,811)	16.50	(18,390)	16.50
End of year	<u>399,948</u>	<u>\$ 16.50</u>	<u>424,759</u>	<u>\$ 16.50</u>
Exercisable	<u>-</u>	<u>\$ 16.50</u>	<u>312</u>	<u>\$ 16.50</u>
Shares available for future grants under the plan as End of Year		<u>763,536</u>		<u>738,725</u>
Weighted-average grant date fair value		<u>\$ -</u>		<u>\$ -</u>
Weighted-average remaining contractual life		<u>4.5 years</u>		<u>5.5 years</u>

9. CONCENTRATION OF CREDIT RISK

Financial instruments, which potentially subject the Company to concentration of credit risk, consist principally of temporary cash investments and trade receivables. The Company places its temporary cash investments with credit-worthy, high-quality financial institutions.

The Company's customer base is concentrated in the healthcare industry. Customers are located throughout the United States. The Company requires no collateral or other security to support customer receivables. An allowance for doubtful accounts has been established for potential credit losses based on historical collection experience.

10. FAIR VALUES OF FINANCIAL INSTRUMENTS

Cash, cash equivalents, accounts receivable, accounts payable and accrued liabilities are reflected in the accompanying financial statements at cost, which approximates fair value because of the short-term maturity of these instruments. Based on the borrowing rates currently available to the Company for bank loans with similar terms and average maturities, at December 31, 2004 and 2003 the fair values of the note payable and financing receivables approximate book value.

11. FINANCING RECEIVABLES

The Company leases its information and patient care systems to certain healthcare providers under sales-type leases expiring in various years through 2009. These receivables typically have terms from 2 to 5

years, bear interest at various rates, and are usually collateralized by a security interest in the underlying assets. Since the Company has a history of successfully collecting all amounts due under the original payment terms of these extended payment arrangements without making any concessions to its customers, the Company satisfies the requirement of SOP 97-2 for revenue recognition. The Company's history with these types of extended payment term arrangements supports management's assertion that revenues are fixed and determinable and probable of collection.

The components of these lease receivables were as follows on December 31:

	2004	2003
Total minimum lease payments receivable	\$ 1,073,547	\$ 1,690,917
Less unearned income	(171,599)	(232,867)
Lease receivables	901,948	1,458,050
Less current portion	(284,291)	(665,947)
Amounts due after one year	<u>\$ 617,657</u>	<u>\$ 792,103</u>

Future minimum lease payments to be received at December 31, 2004 are as follows:

2005	\$ 357,929
2006	239,627
2007	239,627
2008	181,865
2009	54,499
Total minimum lease payments to be received	<u>1,073,547</u>
Less unearned income	(171,599)
Net leases receivable	<u>\$ 901,948</u>

The Company has also sold information and patient care systems to certain healthcare providers under extended payment terms. These receivables, included in current portion of financing receivables, typically have terms from 3 to 12 months. Total amounts receivable under these arrangements at December 31, 2004 and 2003 were \$689,869 and \$448,595 (of which \$1,768 is included as a long-term asset), respectively.

12. BENEFIT PLANS

In January 1994, the Company adopted the Computer Programs & System, Inc. 401(k) Retirement Plan that covers all eligible employees of the Company who have completed one year of service. The plan allows eligible employees to contribute up to 15% of their pre-tax earnings up to the statutory limit prescribed by the Internal Revenue Service. The Company matches the first \$1,000 contribution per participant plus a discretionary amount determined by the Company. The Company contributed approximately \$1,059,000, \$935,000 and \$816,000 to the plan for the years ended December 31, 2004, 2003 and 2002, respectively.

The Company provides certain health and medical benefits to eligible employees, their spouses and dependents pursuant to a benefit plan funded by the Company. Each participating employee contributes to the Company's costs associated with such benefit plan. The Company's obligation to fund this benefit plan

and pay for these benefits is limited through the Company's purchase of an insurance policy from a third-party insurer. The amount established as a reserve is intended to recognize the Company's estimated obligations with respect to its payment of claims and claims incurred but not yet reported under the benefit plan. Management believes that the recorded liability for medical self-insurance at December 31, 2004 and 2003 is adequate to cover the losses and claims incurred, but these reserves are necessarily based on estimates and the amount ultimately paid may be more or less than such estimates.

13. OPERATING LEASES

The Company leases certain real property, all of which is owned by entities that are owned by one or more stockholders of the Company. The lease agreements have terms of ten years and expire on or before June 2013. For the second five years of the leases, the rental may be adjusted with consent of the landlord and the Company. If mutual consent cannot be obtained, the rental for the second five years will remain the same as the first five years. For the years ended December 31, 2004, 2003 and 2002, total rent expense paid to related parties was approximately \$1,385,000, \$1,325,000 and \$1,112,000, respectively.

The future minimum lease payments payable under operating leases subsequent to December 31, 2004 are as follows:

2005	\$ 1,391,664
2006	1,391,664
2007	1,391,664
2008	1,391,664
2009	1,391,664
Thereafter	<u>3,314,754</u>
	<u>\$ 10,273,074</u>

14. CONTINGENCIES

From time to time, the Company is involved in routine litigation that arises in the ordinary course of business. Management does not expect this to have a material adverse effect on the Company's financial statements.

15. SUBSEQUENT EVENT

On February 1, 2005, the Company announced a dividend for the first quarter of 2005 in the amount of \$0.22 per share.

16. QUARTERLY FINANCIAL STATEMENTS (UNAUDITED)

The following table presents a summary of our results of operations for our eight most recent quarters ended December 31, 2004. The information for each of these quarters is unaudited and has been prepared on a basis consistent with the audited financial statements. This information includes all adjustments, consisting only of normal recurring adjustments, we consider necessary for fair presentation of this information when read in conjunction with the audited financial statements and related notes. Our operating results have varied on a quarterly basis and may fluctuate significantly in the future.

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
	(in thousands except for share and per share data)			
Year Ended December 31, 2004				
Sales revenues	\$ 18,212	\$ 19,014	\$ 21,132	\$ 24,306
Gross profit	6,496	7,542	8,422	10,628
Operating income	1,139	2,353	3,337	4,374
Net income	755	1,449	2,086	2,774
Net income per share				
Basic	0.07	0.14	0.20	0.26
Diluted	0.07	0.14	0.20	0.26
Weighted average shares outstanding				
Basic	10,489,849	10,489,849	10,489,849	10,489,849
Diluted	10,527,101	10,531,893	10,533,388	10,549,706
Year Ended December 31, 2003				
Sales revenues	\$ 20,075	\$ 19,908	\$ 19,591	\$ 21,729
Gross profit	8,037	8,320	7,319	9,223
Operating income	3,224	3,308	2,278	3,735
Net income	2,071	2,112	1,461	2,222
Net income per share				
Basic	0.20	0.20	0.14	0.21
Diluted	0.20	0.20	0.14	0.21
Weighted average shares outstanding				
Basic	10,488,000	10,488,000	10,488,000	10,488,181
Diluted	10,569,223	10,543,577	10,524,832	10,510,879

SCHEDULE II
COMPUTER PROGRAMS AND SYSTEMS, INC.
VALUATION OF QUALIFYING ACCOUNTS

Description	(1) Additions				(2) Deduction s	Balance at end of period
	Balance at beginning of period	charged to cost and expenses				
Allowance for doubtful accounts deducted from accounts receivable in the balance sheet	2002	\$ 532,000	\$ 818,000	\$ 582,000	\$ 768,000	
	2003	768,000	257,000	121,000	904,000	
	2004	904,000	1,342,000	610,000	1,636,000	

(1) Adjustments to allowance for change in estimates.

(2) Uncollectible accounts written off, net of recoveries.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES.

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)), as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company that is required to be included in our periodic Securities and Exchange Commission filings.

There have not been any changes in the Company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) during the fourth quarter of 2004 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Annual Report on Internal Control Over Financial Reporting

This report is included in Item 8 on page 38 and is incorporated herein by reference.

Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

This report is included in Item 8 on page 40 and is incorporated herein by reference.

ITEM 9B. OTHER INFORMATION.

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

We have adopted a Code of Business Conduct and Ethics applicable to all of our directors, officers (including our Chief Executive Officer and senior financial officers) and employees. We have also adopted a separate code of ethics with additional guidelines and responsibilities applicable to our Chief Executive Officer and senior financial officers, known as the Code of Ethics for CEO and Senior Financial Officers. Copies of the Code of Business Conduct and Ethics and the Code of Ethics for CEO and Senior Financial Officers are incorporated by reference in this Form 10-K as Exhibit 14.1 and Exhibit 14.2, respectively.

Other information required by this Item regarding Executive Officers is included in Part I of this Form 10-K under the caption "Executive Officers" in accordance with Instruction 3 of the Instructions to Paragraph (b) of Item 401 of Regulation S-K.

Other information required by this Item is incorporated by reference pursuant to General Instruction G(3) of Form 10-K from CPSI's definitive Proxy Statement for the 2005 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference pursuant to General Instruction G(3) of Form 10-K from CPSI's definitive Proxy Statement for the 2005 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Certain of the information required by this Item is incorporated by reference pursuant to General Instruction G(3) of Form 10-K from CPSI's definitive Proxy Statement for the 2005 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item is incorporated by reference pursuant to General Instruction G(3) of Form 10-K from CPSI's definitive Proxy Statement for the 2005 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated by reference pursuant to General Instruction G(3) of Form 10-K from CPSI's definitive Proxy Statement for the 2005 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) and (2) and (d) - Financial Statements and Financial Statement Schedules.

Financial Statements: The Financial Statements and related Financial Statements Schedule of CPSI are included herein in Part II, Item 8.

(a)(3) and (b) – Exhibits.

The exhibits listed on the Exhibit Index at page 62 of this Form 10-K are filed herewith or are incorporated herein by reference.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on this the 15th day of March, 2005.

COMPUTER PROGRAMS AND SYSTEMS, INC.

By: /s/ David A. Dye
David A. Dye
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>Name</u>	<u>Title</u>	<u>Date</u>
<u>/s/ John Morrissey</u> John Morrissey	Chairman of the Board and Director	March 9, 2005
<u>/s/ David A. Dye</u> David A. Dye	President, Chief Executive Officer and Director (principal executive officer)	March 15, 2005
<u>/s/ J. Boyd Douglas</u> J. Boyd Douglas	Executive Vice President, Chief Operating Officer and Director	March 15, 2005
<u>/s/ M. Stephen Walker</u> M. Stephen Walker	Vice President - Finance and Chief Financial Officer	March 15, 2005
<u>/s/ Darrell G. West</u> Darrell G. West	Controller (principal accounting officer)	March 15, 2005
<u>/s/ Dennis P. Wilkins</u> Dennis P. Wilkins	Director	March 7, 2005
<u>/s/ M. Kenny Muscat</u> M. Kenny Muscat	Director	March 9, 2005
<u>/s/ Ernest F. Ladd, III</u> Ernest F. Ladd, III	Director	March 9, 2005
<u>/s/ W. Austin Mulherin, III</u> W. Austin Mulherin, III	Director	March 7, 2005
<u>/s/ William R. Seifert, II</u> William R. Seifert, II	Director	March 15, 2005
<u>/s/ Hal L. Daugherty</u> Hal L. Daugherty	Director	March 15, 2005
<u>/s/ John C. Johnson</u> John C. Johnson	Director	March 8, 2005
<u>/s/ Charles P. Huffman</u> Charles P. Huffman	Director	March 15, 2005

Exhibit Index

<u>Exhibit Number</u>	<u>Description</u>
3.1	Certificate of Incorporation (filed as Exhibit 3.4 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
3.2	Bylaws (filed as Exhibit 3.6 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
10.1	Real Property Lease, dated April 1, 2002, between CPSI and CP Investments, Inc. (filed as Exhibit 10.1 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
10.2	Real Property Lease dated April 1, 2002, between CPSI and DJK, LLC (filed as Exhibit 10.2 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
10.3*	2002 Stock Option Plan (filed as Exhibit 10.3 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
10.4*	Form of Non-Qualified Stock Option Agreement for executive officers (filed as Exhibit 10.4 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
10.5	Form of Indemnity Agreement entered into by CPSI and each of its non-employee directors (filed as Exhibit 10.1 to CPSI's Quarterly Report on Form 10-Q for the period ended September 30, 2002 and incorporated herein by reference)
10.6	Real Property Lease, dated October 1, 2002, between CPSI and CP Investments, Inc. (filed as Exhibit 10.10 to CPSI's Annual Report on Form 10-K for the period ended December 31, 2002 and incorporated herein by reference)
10.7	Real Property Lease, dated November 1, 2002, between CPSI and CP Investments, Inc. (filed as Exhibit 10.11 to CPSI's Annual Report on Form 10-K for the period ended December 31, 2002 and incorporated herein by reference)
10.8	Real Property Lease, dated June 16, 2002, between CPSI and CP Investments, Inc. (filed as Exhibit 10.12 to CPSI's Annual Report on Form 10-K for the period ended December 31, 2003 and incorporated herein by reference)
14.1	Code of Business Conduct and Ethics (filed as Exhibit 14.1 to CPSI's Annual Report on Form 10-K for the period ended December 31, 2003 and incorporated herein by reference)
14.2	Code of Ethics for CEO and Senior Financial Officers (filed as Exhibit 14.2 to CPSI's Annual Report on Form 10-K for the period ended December 31, 2003 and incorporated herein by reference)
23.1	Consent of Grant Thornton LLP, Independent Registered Public Accounting Firm
23.2	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Compensation plan or agreement

directors and officers

Board of Directors

David A. Dye
President and Chief Executive Officer
Computer Programs and Systems, Inc.

William R. Seifert, II
Executive Vice President
AmSouth Bank

J. Boyd Douglas, Jr.
*Executive Vice President and
Chief Operating Officer*
Computer Programs and Systems, Inc.

Dennis P. Wilkins
*Retired President and
Chief Executive Officer*
Computer Programs and Systems, Inc.

Ernest F. Ladd, III
*Retired Executive Vice President
and Chief Financial Officer*
Dravo Corporation

Hal L. Daugherty
Chief Executive Officer
The Heart Group, P.C.

John W. Morrissey
*Retired Vice President, Sales
and Marketing*
Computer Programs and Systems, Inc.

John C. Johnson
Real Estate Appraiser
Courtney & Morris Appraisals, Inc.

W. Austin Mulherin, III
Attorney
Frazer, Greene, Upchurch & Baker, LLC

Charles P. Huffman
*Senior Vice President and
Chief Financial Officer*
EnergySouth, Inc.

M. Kenny Muscat
*Retired Executive Vice President
and Chief Operating Officer*
Computer Programs and Systems, Inc.

Officers

David A. Dye
President and Chief Executive Officer

M. Stephen Walker
*Vice President of Finance and
Chief Financial Officer*

J. Boyd Douglas, Jr.
*Executive Vice President and
Chief Operating Officer*

**Independent Registered
Public Accounting Firm**

Grant Thornton LLP
Marquis One
Suite 300
245 Peachtree Center Avenue, NE
Atlanta, GA 30303

Transfer Agent

Wachovia Bank, N.A.
Equity Services Group
1525 West W. T. Harris Blvd., 3C3
Charlotte, NC 28262-1153

Legal Counsel

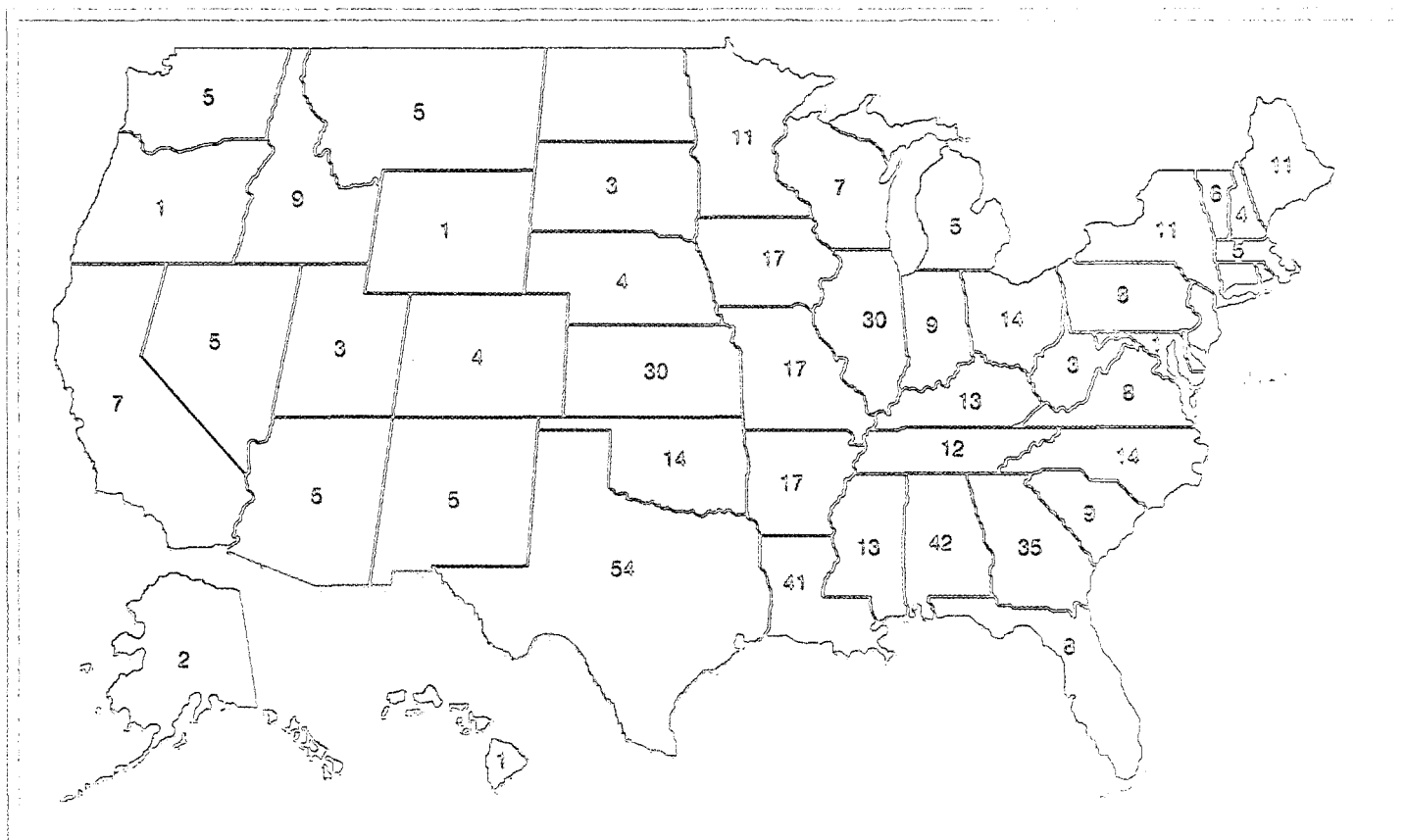
Maynard, Cooper & Gale, P.C.
1901 Sixth Avenue North
Suite 2400, AmSouth/Harbert Plaza
Birmingham, AL 35203-2618

Corporate Headquarters

Computer Programs and Systems, Inc.
6600 Wall Street
Mobile, AL 36695
(251) 639-8100
www.cpsinet.com

Common Stock

Computer Programs and Systems, Inc.'s
common stock is traded on The NASDAQ
Stock Market's National Market under the
symbol CPSI.



hospital customer locations

CPSI

6600 Wall Street
Mobile, AL 36695